A STRATEGIC ANALYSIS OF
A BOUTIQUE INVESTMENT FIRM

By

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Abstract

This paper is a strategic analysis of a boutique investment company operating in Vancouver, British Columbia. The paper examines the company and the investment management industry both in Canada and internationally. The analysis shows how profits have been eroded by stagnated growth of the industry and increased regulatory requirements. In order to grow, successful firms must look for new clients in the developing economies where the investment industry is still growing, take existing clients away from other firms through direct competition or change their business model. The developed market itself is shown to be undergoing a significant change in its demographic makeup with a shift towards a higher percentage of retirement aged population looking for different products than they did when they were middle aged.

The paper concludes with a strategic option for the firm which sees it focus on retirement based products built around increased returns and lower risk. This option will allow the firm to take advantage of the demographic shifts and sets it up to be a strong competitor in the market.

Keywords: investment management industry Canada, strategy

Dedication

I would like to dedicate this project to my wife Caroline whose unwavering support has made my journey through the program possible. All those late evening editing sessions have finally paid off.

Acknowledgment

I would like to thank Professor Andrew von Nordenflycht whose comments and insights were invaluable in allowing me to pull my thoughts together. I would also like to thank the SFU business school faculty for sharing their experience and wisdom making the program a great experience and a big thank you to the SFU staff that organized everything and allowed the program to be so much more than pure academia.

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1 Introduction

This paper is a strategic analysis of Dovos Capital Management[1], a boutique investment company operating in Vancouver, British Columbia. Dovos has been operating for over 20 years and it is now experiencing increased pressures driven by market forces. The company must adapt and grow or face an uncertain future. The investment industry in Canada is experiencing rapid change, driven by economic, demographic, regulatory and technological changes. Business models from past decades are no longer competitive and market forces have created new opportunities which companies can take advantage of.

The paper strives to answer the question of how Dovos can reverse some recent setbacks and grow its revenue while faced with the challenges of a stagnant market and increased competition.

The analysis is divided into six major sections. The first introduces and provides an overview of the company. The second section discusses the company's own position, current strategy and strengths. The third section examines the external environment, how the company compares against its competitors and what trends are shaping the competitive landscape. It also includes an analysis of Porter's Five Forces in the industry. The fourth section constructs and ranks strategic options which address the company's needs and fit with the internal and external realities. The fifth section analyzes the options for their feasibility. The sixth section selects one of these options as the final recommendation and provides an implementation roadmap.

[1] Dovos Capital Management Inc. and several other company names are fictional. Some identifying details have also been changed in order to hide the company's true identities.

2 Organization’s Current Position

2.1 Company Overview

Dovos Capital Management Inc. is a small, privately owned investment company managing over $1.2 billion in assets. The company’s own products consist of financial planning services and equity investments in Canada, the United States and Developed Markets. The company outsources, through sub-advisors, fixed income and Emerging Markets investments. Additionally, Dovos offers pure research services to institutional clients who have their own trade execution capabilities.

Dovos’ main office is located in downtown Vancouver, British Columbia with a virtual office located in Calgary, Alberta for better servicing of its clients in central Canada.

2.1.1 History

Dovos Capital Management Inc. was founded in 1986 by three partners. The founding vision for the company was to provide institutional level investment service to private individuals, who typically only have access to consumer retail investment products.

During the 2008 financial crisis, Dovos was severely impacted by the collapse of asset backed securities and the company weathered the storm by taking on significant liability. Over the past five years, Dovos has reduced this liability to near zero, which has freed up resources that can now be invested in the company or returned to shareholders.

2.1.2 Organizational Structure of the Company

There are 27 full-time and part-time employees working at Dovos, divided into 5 departments: Investment, Sales and Client Service, Marketing, Administration and IT. Figure 2-1 lays out the organizational and reporting structure of the company.

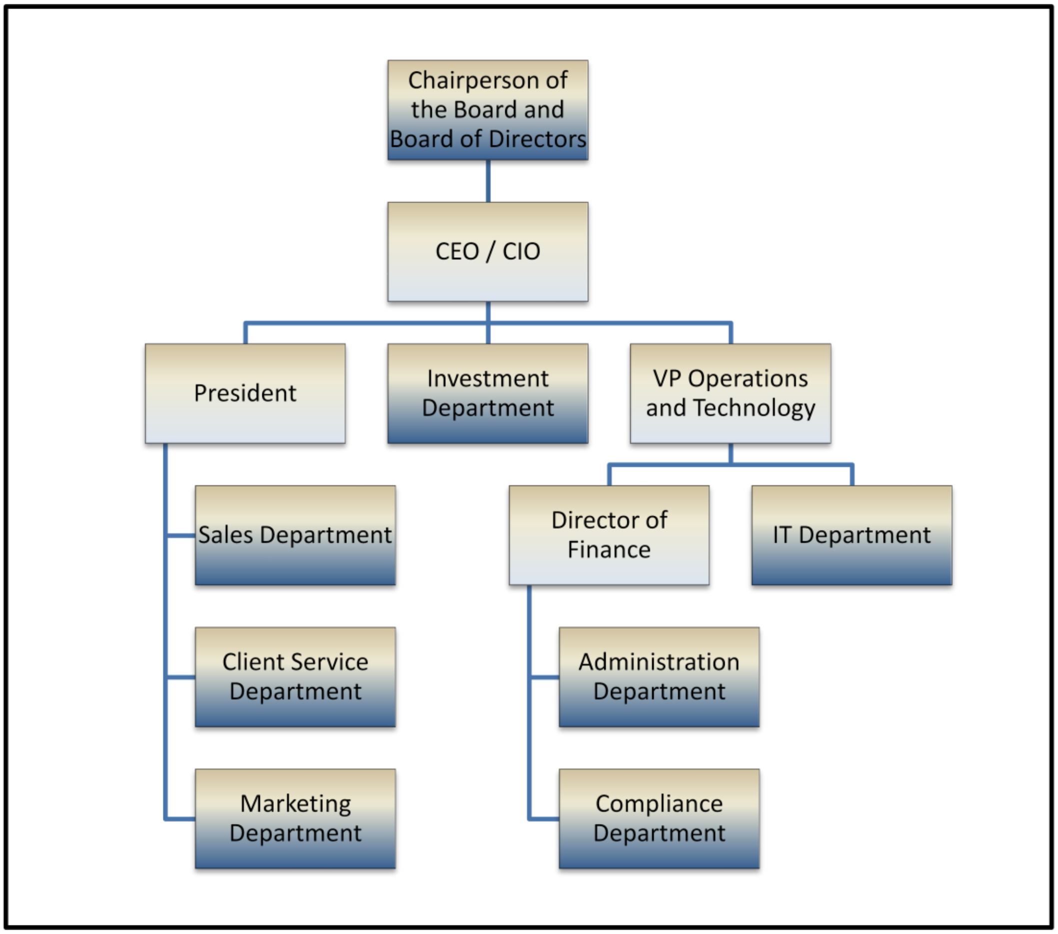

Figure 2-1 Organizational chart. Source: Author

Dovos has a 3 person Board of Directors with an Advisor to the Board. The CEO reports to the Chairperson of the Board. The Chief Investment Officer (CIO), who is also the CEO, manages the Investment Department. The President manages the Sales and Client Service Department and the Marketing Department. The VP Operations and Technology manages the Administration Department and the IT Department.

2.1.2.1 Investment Department

The investment department is tasked with conducting research and constructing portfolios as well as with implementing the portfolios by executing trades through a 3rd party professional trade system. Additionally, the investment department is responsible for providing content for some marketing brochures, market updates and client presentations.

2.1.2.2 Sales and Client Service

This is the largest department and it is responsible for retaining existing clients and for finding new clients. The Sales side is composed of Portfolio Managers who, in addition to finding new clients, are responsible for the overall portfolio strategy of each client. It is up to the Portfolio Managers to work with the clients, understand their individual situations and to create complete investment portfolios which fit with their goals.

The Client Service side is responsible for the execution of client requests such as deposits, redemptions and transfers. They also provide assistance to the Portfolio Managers by preparing reports, presentations and other client communications. The Client Service department is part of what is referred to as the Back Office.

2.1.2.3 Marketing

The marketing department is very small and consists of one full-time writer and one part-time graphic designer. It is their responsibility to create content which goes into brochures, presentations, product pitches as well as to maintain the Dovos website, blog and other social media presence.

2.1.2.4 Administration

The Administration department consists of 4 full-time and 1 part time employees. They are the core of the Back Office and it is their responsibility to provide Fund Accounting services, Compliance, Corporate Accounting and Trade processing and settlement. The Administrative department is also the primary body whose output is audited annually by Ernst & Young, a 3rd party auditor, to ensure that Dovos satisfies provincial and federal legislative requirements.

2.1.2.5 IT

The IT department consists of 3 full-time employees. The department is divided into two functional areas: Network Administration and Application Development. The Network Administrator is responsible for maintaining, upgrading and improving the company's core technical infrastructure. Dovos' quantitative research methodology requires a significant investment in technology, including professional grade databases, servers and connections to market data vendors.

The Application Development team consists of 2 people who are responsible for implementing and improving Dovos tools. These tools automate Back Office tasks and connect Dovos to 3rd party service providers such as custodians and data vendors. Additionally, the application developers are constantly enhancing the client portfolio management and accounting software so that the Client Service team can be flexible in fulfilling client needs.

2.1.2.6 Independent IT Contractors

Dovos employs IT contractors as needed for specific projects which require skills and expertise not possessed by the IT staff. The most significant of these relationships is the extended contract for development of proprietary Investment Research and Modeling technology. It is through this technology that Dovos competes with other investment managers which makes it critical.

2.2 Overview of Dovos Customers

Dovos customers can be divided into two major market segments (Silk, 2006) based on their characteristics: Private Investors and Institutional Investors.

2.2.1 Private Investment Clients

These are families or individuals with over $500,000 in investable assets. They are primarily concerned with retirement savings and providing for their own and their family's future. Most of them value service, predictable investment returns and trusted relationships.

2.2.2 Institutional Investor Customers

These are pension funds, foundations, insurance companies or large investment companies which are outsourcing all or segments of their portfolios. The pension funds and foundations are typically interested in the protection of their capital from market losses, transparency and planning for their forecasted liabilities.

These customers can be further segmented based on whether they require the investment products to only hold companies which are Socially Responsible or whether they can hold any company. The customers who do require Socially Responsible Investments (SRI) also require specialized commentary and guarantees that all of their holdings meet ethical criteria. The SRI customers account for about 11% of the total revenue.

Insurance companies and large investment companies who outsource parts of their strategy to Dovos are primarily interested in returns against their policy benchmark. These customers are least interested in relationship building and are most likely to leave if the investment results fall below set expectations.

The customer “assets under management” relative breakdown is shown in Figure 2-2.

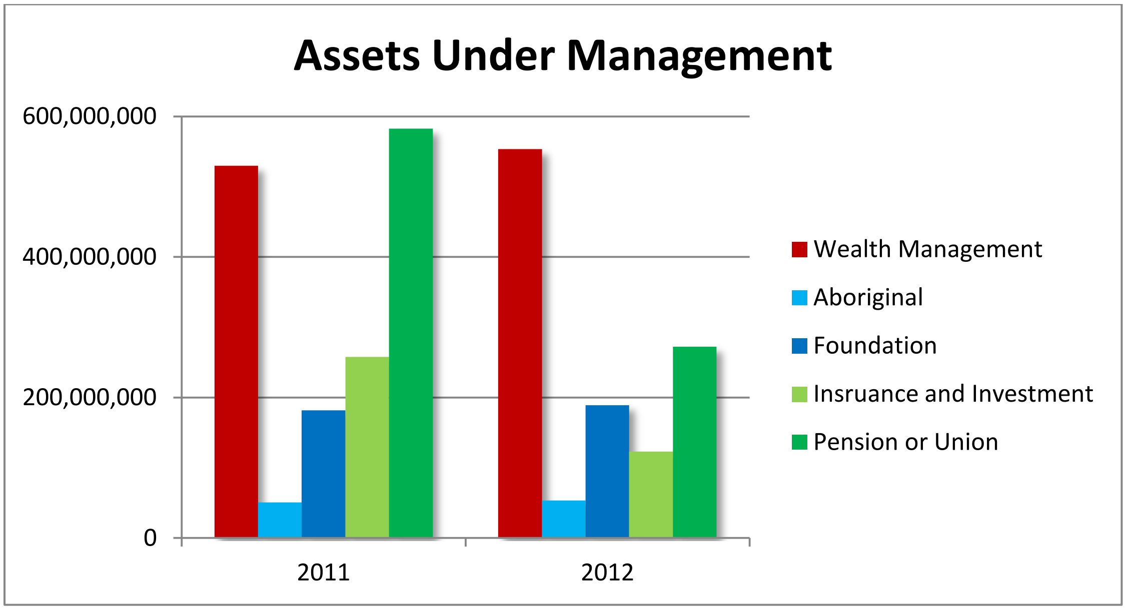

Figure 2-2 Assets under management by client segment in 2011 and 2012. Source: Author.

The chart shows a reduction of $445,000,000 in AUM from the Insurance and Investment and the Pension or Union clients. This loss represents 28% of the total AUM and was caused by 3 large clients leaving Dovos. This is discussed further in the section outlining the revenue model and the current challenges.

2.3 Overview of Dovos Products

Dovos manufactures the majority of its product as measured by percent of total AUM, with a portion of the product being outsourced to sub-advising partners. The Dovos manufactured products are composed of Pooled Funds and individual custom portfolios referred to as Segregated Assets. Figure 2-3 shows the proportional share of total AUM by Dovos product types.

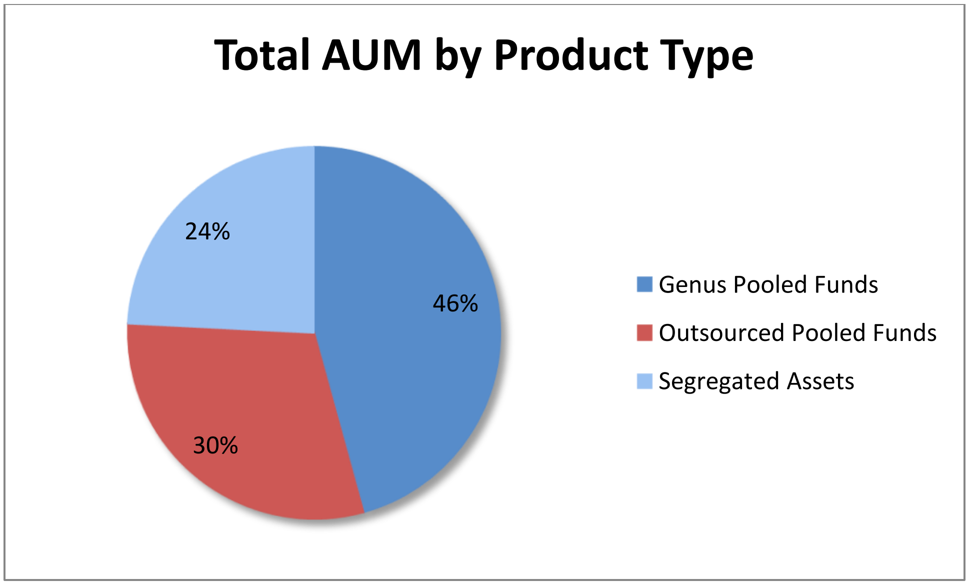

Figure 2-3: Product types as percent of total AUM. Source: Author.

2.3.1 Products Manufactured at Dovos

Dovos is an equity specialist and therefore its entire manufactured investment product lineup is composed of equities in Canada, United States and Developed Markets. The investment mandates of the individual pools are designed to provide basic building blocks for Portfolio Managers to meet individual client asset mix needs. In addition to Pooled Funds which hold equities, Dovos also provides the Balanced Fund which is a mix of specific individual Pooled Funds or a "Fund of Funds". The Balanced Fund is designed to fit most common private customer needs and provides a great foundation for most private portfolios. Table 2-1 shows pooled funds manufactured at Dovos.

Pooled Fund (Component) Name	Pooled Fund Mandate or Strategy	Percent of Total AUM
Core Products		
Dovos Canadian Equity	Pure Canadian equity fund. Uses core Alpha strategy	2%
Dovos Canadian T-Bill	Cash equivalents fund. Used to provide immediate liquidity	2%
Dovos GlobeCan Equity	Canadian, US and Developed Markets Equity strategy	14%
Dovos Dividend Equity	Canadian, US and Developed Markets Dividend income focused strategy	20%
Dovos Global Equity	US and Developed Markets Equity strategy	4%
Specialty Products		
Dovos Balanced Fund	Fund of Funds. Mix of Core Products designed for typical private investor.	4%
Dovos Biosphere Plus Canadian Equity	Socially Responsible Canadian Equity core Alpha strategy. Required by some Foundations.	2%
Dovos Biosphere Plus Global Equity	Socially Responsible Developed Markets core Alpha strategy. Required by some Foundations	2%

Table 2-1: Manufactured Dovos pooled funds breakdown by AUM in 2012. Source: Author.

In addition to Pooled Funds, Dovos creates customized individual portfolios called Segregated Portfolios for larger clients who require a unique strategy or who simply have sufficient assets to afford direct stock ownership. These Segregated Portfolios typically follow one of Dovos' Core strategies with some small specialized changes around exposure to Risk, Market Volatility or other factors.

Dovos also provides the majority of its customers with the asset mix designed to fit with their individual needs. The asset mix is optimized for asset geographic exposure and asset class. Additionally, Dovos makes the funds available for purchase on an individual basis in order to accommodate some institutional customers, who wish to retain the asset mix responsibility.

In addition to directly investing customer's money through funds or segregated portfolios, Dovos also provides some institutional customers with Guided Portfolios or Separately Managed Accounts (SMA). These clients receive only the stock choices, and it is up to the clients themselves to trade the securities. This is most commonly used as an outsourcing mechanism by large investment institutions such as Scotia Bank. These SMA portfolios allow the institution to purchase specialized investment mandates and to diversify their own investment product lineup.

2.3.2 Products Outsourced to Dovos Partners

Dovos outsources the investment of Fixed Income and Emerging Markets products to sub-advising partners in order to compensate for its specialization in equity and geographic products. Table 2-2 shows the pooled funds outsourced to Dovos sub-advisors. The fees collected on these products are split between Dovos and the sub-advising partner.

Pooled Fund (Component) Name	Pooled Fund Mandate or Strategy	Percent of Total AUM
Fixed Income Products	**Provided by Sunmont Capital**	
Dovos Biosphere Plus Bond	Socially Responsible Fixed Income Strategy. Required by some Foundations.	3%
Dovos Canadian Bond	Canadian Fixed Income strategy.	3%
Dovos Short-Term Corporate Bond	Global Corporate bond strategy designed for higher yields at higher risk.	4%
Dovos Strategic Bond	Global Fixed Income strategy designed for minimal risk.	13%
Dovos Commercial Mortgage	Canadian Commercial Mortgage Fixed Income diversification strategy.	5%
Other Products	**Provided by Bernstein Capital**	
Dovos Emerging Markets	Emerging Markets aggressive growth strategy.	2%

Table 2-2: Outsourced Dovos pooled funds. Source: Author

2.3.3 Product Categories by Investment Strategy

The general strategy used to manage the money and the outcomes expected by the clients are an important horizontal differentiation (Silk, 2006) of the products.

2.3.3.1 Absolute Growth Focused

These products are typically aimed at private investors. They are based around the Balanced Fund and are focused on growing assets over the long term for eventual withdrawal at retirement. The Balanced Fund is composed of the other funds and so its performance is heavily influenced by the performance of the other strategies such as the Income Focused and Benchmark Focused strategies.

2.3.3.2 Income Focused

These products are typically aimed at Foundations and Pension Funds. They are based around the Dividend Fund and Fixed Income Funds and are focused on providing the investor with a steady and reliable income from the assets without depleting them. They are also a good match for retired individuals living off their savings.

2.3.3.3 Benchmark Focused

Benchmark focused products are also referred to as Core Alpha. These products are typically aimed at Institutions and some Pension Funds. They are based around closely following and outperforming market indexes. The performance is always reported relative to whatever benchmark was selected. These benchmarks are typically mixes of Equity Indexes such as the S&P TSX. In order to control the investment’s risk, the investing client typically places hard constraints on how much the product can vary from the benchmark in its holdings. While this does tie the risk to the market, it also limits the ability for the investment manager to significantly beat the benchmark.

2.3.4 Product Distribution Channels

Dovos distributes its products through a number of channels. Figure 2-4 illustrates the revenue share across distribution channels.

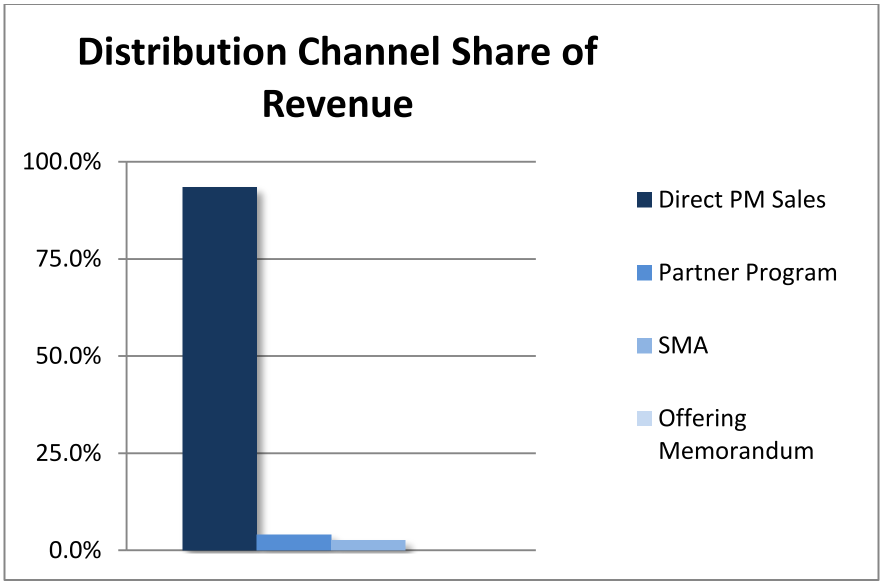

Figure 2-4: Revenue share across distribution channels. Source: Author.

2.3.4.1 Direct Sales by Portfolio Managers

This distribution channel has been used by Dovos exclusively for the first 15 years of the company's existence and it accounts for 93% of the revenue. It is a form of personal selling (Silk, 2006) and it consists of the Portfolio Managers making direct connections with clients. The advantage of this channel is that Dovos realizes maximum profit per AUM. The disadvantage of this channel is that revenue growth is limited by the number of Portfolio Managers, their personal contacts and the time they have to personally sell Dovos products. Additionally, each Portfolio Manger's personal selling time is diminished by each client they acquire and have to service going forward.

2.3.4.2 Referral Partner Program

This distribution channel has been launched by Dovos over 2 years ago with little effort put into growing the channel until late 2011. The Partner Program accounts for only 4% of current revenue, however, it accounted for approximately 33% of new clients in 2012. This figure is expected to grow to over 50% in 2013. The referral program is a form of indirect promotion (Silk, 2006) and it works by signing formal referral agreements with individuals and companies who have a trusted relationship with institutions and private investors. As compensation for the referral, each partner receives a portion of fee revenue in perpetuity. The majority of this referral fee comes from the Portfolio Manager's revenue portion. This is an excellent opportunity for accountants, lawyers and insurance brokers to make additional money from their existing client relationships.

The advantage of this channel is that Dovos Portfolio Managers get exposed to many new prospects without having to spend personal time sourcing them.

The trade-off for the Partner Program is a reduced profitability from referred clients, as a portion of the revenue is passed on to the referring partner in perpetuity.

2.3.4.3 Separately Managed Assets (SMA)

This distribution channel has been launched by Dovos over 3 years ago; however, its biggest growth was in 2012. It accounts for around 3% of total revenue. The SMA clients are typically institutions which resell the investment product to their own retail clients. The SMA product is different from traditional investment management in that Dovos is not actually making the trades and managing the invested assets. Instead, Dovos sends monthly or quarterly updates of the portfolios to its SMA clients, who then implement their own trading. The SMA model greatly reduces Dovos' costs and risks associated with the portfolios as there are no trades which have to be executed.

The trade-offs of this distribution channel are that Dovos does not have any direct relationships with the final purchasing clients and it does not fully control the final implemented performance of the portfolio. Without the relationships, the demand for the SMA product is driven primarily by performance which is partially out of Dovos' control.

2.3.4.4 Funds Distributed Under Offering Memorandum.

This distribution channel has been launched at the very end of 2012 and does not yet have any revenue. The Offering Memorandum (OM) funds distribution channel makes specific Dovos pooled funds available to other investment managers or independent portfolio managers at whole-sale prices, so that they can re-sell them to their own retail clients. It allows Portfolio Managers across Canada to invest their client's money in Dovos pooled funds and it gives Dovos the widest exposure to the investable assets of potential new retail clients. At the same time, unlike with the SMA distribution channel, Dovos maintains full control over the product's performance.

The trade-off of this distribution channel is similar to the one for the SMA. Dovos does not own any of the retail client relationships and so the money invested with any Dovos OM fund will be controlled by Portfolio Managers who are not motivated to keep the assets invested with Dovos. The second major trade-off is that the Dovos OM pooled funds will be competing against thousands of other mutual funds available to the independent Portfolio Managers, which means that their value proposition must clearly set them apart.

The third trade-off is similar to the one for the Partner Program in that Dovos will have to charge lower, wholesale management fees so that the independent Portfolio Managers can add their own fee markup.

2.4 Financial Overview of the Company

2.4.1 Revenue Analysis

Dovos generates revenue by collecting quarterly fees as a percentage of the AUM. The fee percentage per client decreases as the assets increase which is effectively a bulk purchase discount. Additionally, different customer segments are charged at different rates based on their typical account sizes and willingness to pay. Compared head to head, a single private individual account requires slightly less support work than a single institutional account. While private clients do require personal attention, institutional clients have stricter reporting requirements and demanding multi-person boards. Private individuals have much smaller average accounts than institutions. The average private account size is around $500,000 while the average institutional account is around $10,000,000. Therefore the amount of support work required by the same amount of private AUM is roughly 20 times greater than the amount of support work required by institutional AUM.

In addition to investment performance, private individuals are motivated by the personal relationship with the Portfolio Manager. This is a form of differentiation and it allows Dovos to charge higher fees. Since institutional clients are primarily motivated by performance and not the relationship, they are more likely to look for the best product at the lowest fee.

When combined, these two factors allow the private client fee schedule to be higher than the institutional fee schedule and they make the Private Wealth Management accounts higher revenue generators per AUM than Institutional accounts.

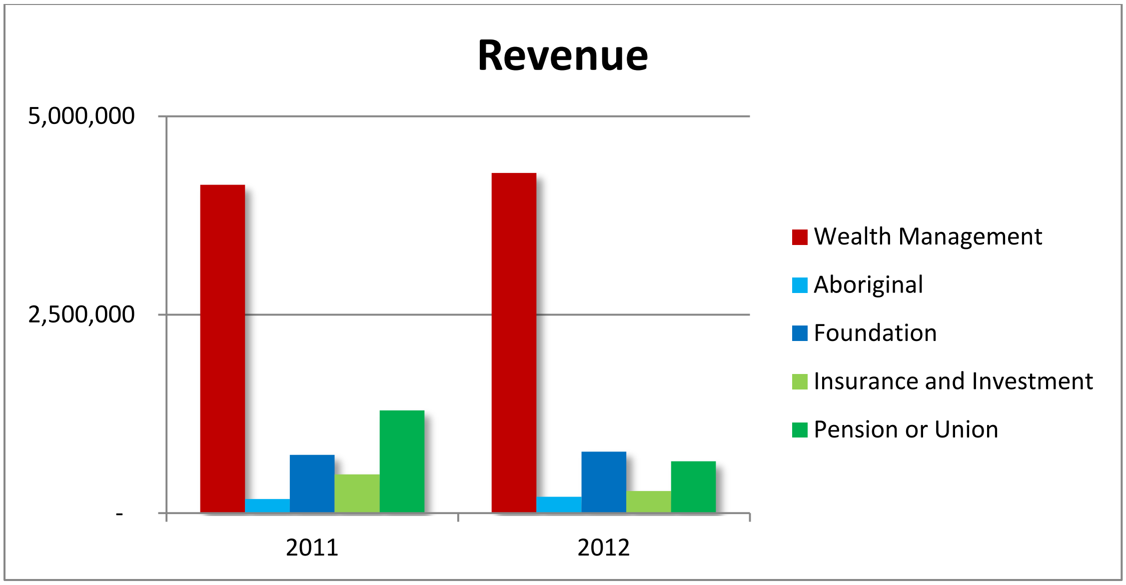

Figure 2-5: Revenue by client segment in 2011 and 2012. Source: Author.

Figure 2-5 shows the revenue breakdown by customer segment and the revenue decline caused by the reduction of Institutional customer AUM. Due to the different rates between Private and Institutional customers, the revenue decline of 12% is not as dramatic as the AUM decline of 28%. Revenue from the other segments has increased, but not quickly enough to offset the losses. Typical annual budgets set the revenue growth target to 3% per year, which has not happened in the past year.

2.4.2 Costs Analysis

Staff compensation is the dominant portion of costs with a total 64% in 2012. Staff compensation is a combination of fixed salary, commission for Portfolio Managers, bonuses and benefits. Sub-Advisor fees are a percentage of revenue generated by outsourced products and referred clients. Fees and Licenses include all professional fees, legal fees, audit costs and software licenses. Office Operations covers all costs associated with running the office including rent, insurance, phones and internet. Client Service and Marketing includes all direct marketing costs, travel, marketing materials print costs, client statement print costs and company website. It is important to note that in the past year, Dovos spent only 4% of total costs on marketing and sourcing new clients excluding staff compensation. Dovos' costs and expenses break-down for the most recent year is illustrated by Figure 2-6.

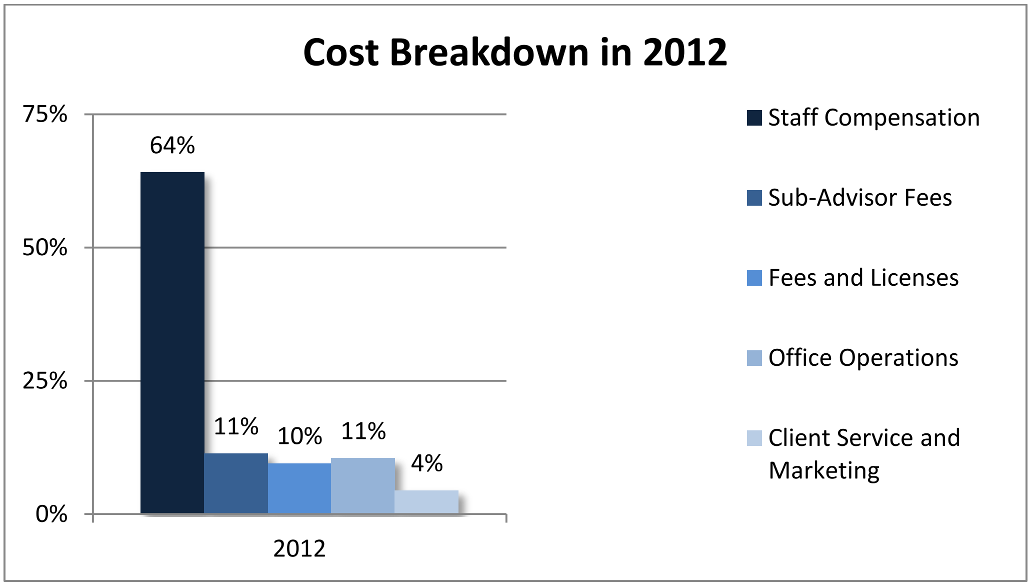

Figure 2-6: Dovos costs breakdown in 2012. Source: Author.

In order to deal with the decrease in total revenue in 2012, Dovos implemented cost cutting measures. Figure 2-7 illustrates the changes in costs from 2011 to 2012.

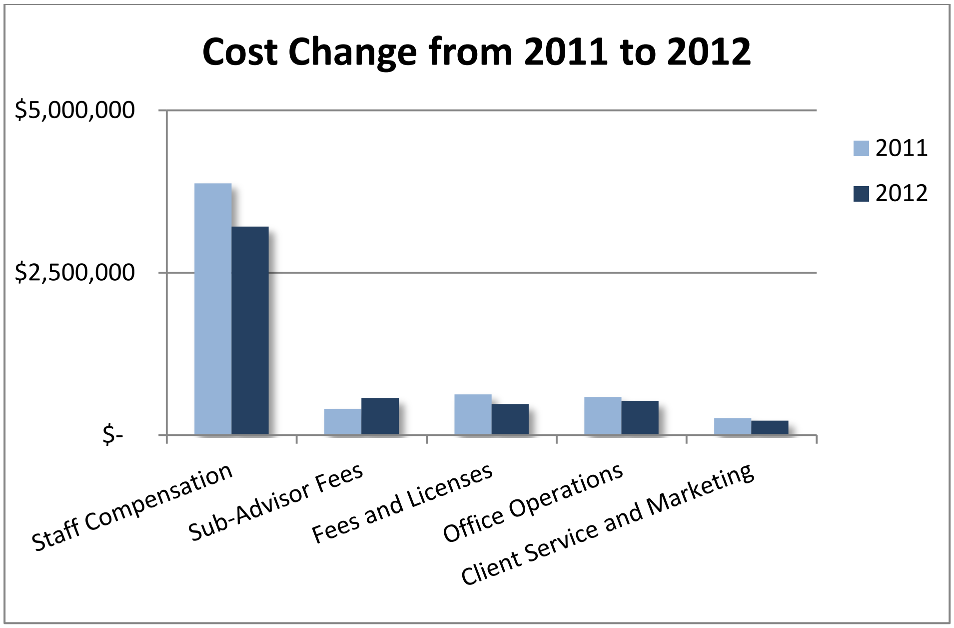

Figure 2-7: Costs breakdown in 2012. Source: Author.

All costs have been decreased with the exception of Sub-Advisor Fees which increased in 2012. The increase is due to a greater number of referral clients and thanks to a new Sub-Advising agreement with Bernstein Capital for an Emerging Markets fund. These changes have protected the margins from 2011 to 2012 as illustrated in Figure 2-8; however they have also reduced the company's ability to find new clients.

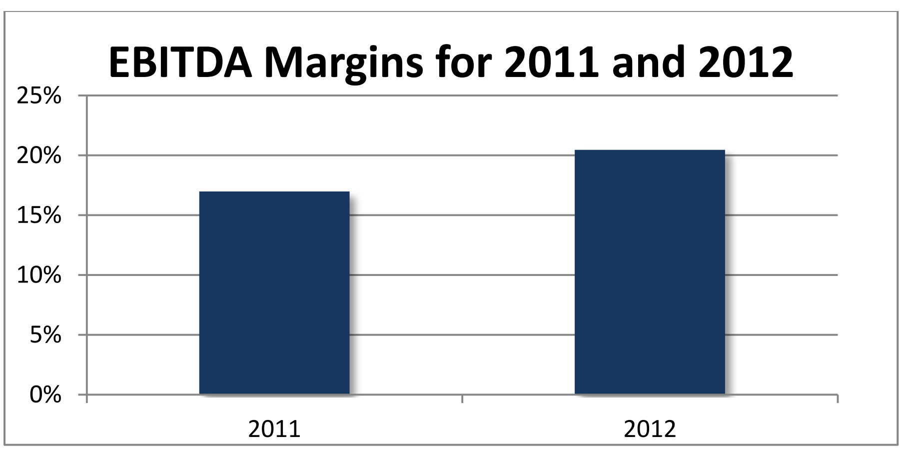

Figure 2-8: Dovos EBITDA margins for 2011 and 2012. Source: Author.

2.5 Strategic Position of the Company

2.5.1 Dovos' Strategic Scope

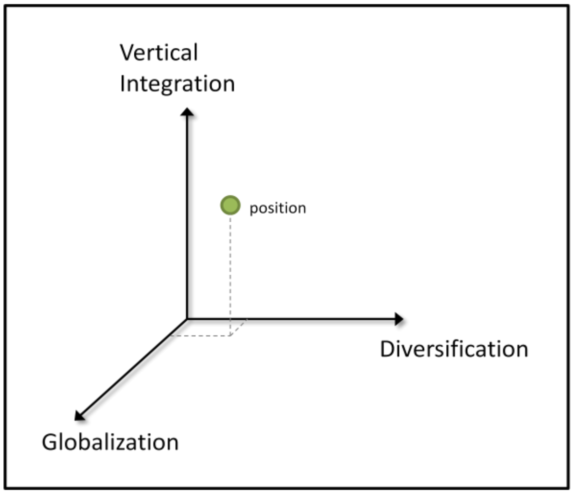

Figure 2-9: Dovos strategic position. Source: Author.

The scope of where Dovos competes is illustrated in Figure 2-9. Dovos is vertically integrated from product manufacturing to distribution. Outsourcing is used for services which require complex regulatory facilities such as being the custodian of assets as well as some commodity services such as daily fund valuation.

The company is highly specialized with investment management being the only service it provides. It is diversified over its client demographics through servicing both private and institutional clients. The company is highly localized with a single physical office in Vancouver and a virtual satellite office in Calgary, both of which target Canadian clients.

2.5.2 Dovos' Strategic Value Proposition

Dovos competes for its customers by trying to focus in on a small number of specific product quality factors.

2.5.2.1 Investment Risk Reduction

Dovos investments are designed to avoid and mitigate market risk. This comes at the price of dampened performance when the market is bullish; however, it has the benefit of significantly reducing losses when the market is bearish. This strategy is based on research which shows that over longer periods of time, strategies which have medium performance on the upside but consistently avoid large draw downs, outperform strategies which alternate between great returns and big losses. The marketing tag line is "make money in the long run by not losing money in the short run."

2.5.2.2 Advanced Portfolio Customization with Back-Testing

Dovos has the ability to highly customize portfolios according to client needs. This is very difficult or impossible for independent or small investment managers. The customization can be quite complex and involves placing thresholds on risk exposure, sectors, trades, yield and how closely the benchmark index is followed. Furthermore, these customized strategies can be back-tested to show how they would have performed over many years. This allows the client and Dovos to collaborate on an optimal custom strategy which meets the client's needs.

2.5.2.3 True Segregated Portfolios for Large Clients

Larger private clients and medium to large institutional clients have the option of investing their money in segregated holdings instead of pooled funds. The advantage of a segregated portfolio is that the client is the actual holder of the underlying assets, which is not the case with Pooled

Funds. Any client invested in a Pooled Fund holds units of the fund, and the fund holds the underlying securities. If for some reason the Pooled Fund goes bankrupt or is incorrectly accounted, the client may end up holding worthless units. This is never the case with segregated holdings where the client is always the holder of the actual securities. For those clients, even if Dovos disappears overnight, their holdings are completely secure with 3rd party custodians such as Royal Bank of Canada Investment Services.

2.5.2.4 Deep Relationship Building and Added Value Service for Private Clients

Dovos encourages its private clients to build deep relationships with the Portfolio Managers. Given that trust is a very important aspect of the relationship, a Dovos client can get to know the Portfolio Manager and the company well. This includes clients having the option to meet key staff, visit the back-office and have the Portfolio Managers visit them at home. This commitment to personal relationships makes the private clients feel more appreciated and attached to the company. It also allows the Portfolio Managers to have a better understanding of the client's true needs.

The Client Service team provides some extra services which are not available at normal retail investment managers. For example, Dovos produces a detailed tax report every quarter which allows the client's accountant to plan their annual tax strategy as the year progresses instead of having to wait for the very end of the year.

The Client Service team at Dovos is committed to meeting the client needs even when they fall outside of the standard operations. For example, if a customer needs to redeem funds on an accelerated schedule, the Client Service team will accommodate if possible.

2.5.3 Dovos' Strategic Investment

Dovos has made a number of choices and investments which are meant to support its value proposition.

2.5.3.1 Controlling the Costs

Dovos has been consciously keeping its costs suppressed so that it has a cost advantage when pricing its product. The cost strategy is implemented through the following processes.

Dovos is always trying to build its annual budget to achieve a margin target of 30%. This naturally curbs any spending which is not truly necessary.

Dovos office space has a no-frills feel and finish. While it is professional and clean, Dovos has avoided expensive furniture and decorations which are common at many other investment managers. In addition to keeping the costs down, it signals to our clients that we are serious about keeping our fees low and not wasting their money.

Additionally, Dovos is heavily investing in improvements of automation and efficiency. The constant overarching goal is to do more work with fewer people. For example, in 2010, the monthly portfolio complete rebalance process required an IT professional for 2 weeks every month to load and prepare the market data and to run the models. By 2012 this has been reduced to 2 days per month.

The IT department has a number of cost controlling policies including recycling of workstations from the investment staff that need high-end machines, through the Back Office staff that can use mid-tier machines all the way to the Portfolio Managers and receptionist who can use low-end machines.

2.5.3.2 Extensive Quantitative Research Capability

Dovos has built an advanced quantitative research lab which is capable of conducting complex portfolio and strategy simulations over decades of past market data. The lab consists of 3 researchers, 3rd party industry software, 3rd party global market data and Dovos custom technology. The lab allows Dovos to research its own investment product and it allows Dovos to design and test custom client strategies which can have a variety of complex restrictions and requirements.

2.5.3.3 Extensive Research of Low-Volatility-High-Yield Strategies

Over the past couple of years, the Dovos investment team has spent considerable time researching and modeling Low Volatility High Yield strategies. This approach has been gaining momentum in the investment industry and Dovos has been at the forefront of the thinking since the beginning. By focusing on these steady returns strategies which avoid sharp downturns, Dovos can play into the long-term thinking of safety conscious clients.

2.5.3.4 Opening up New Distribution Channels

Over the past year, Dovos has made an effort to open new distribution channels and to invigorate existing ones. By investing time into the Partner Program, the SMA portfolios and registering the Offering Memorandum funds, Dovos is mitigating the risk of having all of its revenue growth tied to the three Portfolio Managers on staff.

2.5.3.5 Reusing of Research

Through its use of investment technology, the Investment Team can easily repurpose its research efforts. One of the core products is a ranking of stocks on several characteristics, referred to as Alpha, which can be applied to different portfolios. For example, for portfolios which need lower risk, the researcher will start with the complete Alpha stock list and then apply a specialized Low Volatility Screen which removes volatile stocks. Through multiple screens and other more advanced techniques, the initial complete stock ranking list can be quickly transformed into many different, specialized portfolios.

2.5.3.6 Flexible Custody Arrangements

Dovos has cultivated relationships with multiple custodians such as Royal Bank of Canada Investor Services, Scotia Bank and TD Waterhouse which gives it the flexibility to hold client assets in pooled funds, lower-cost semi-segregated portfolios or premium cost, true segregated portfolios.

2.5.3.7 Client Service Oriented Culture

The entire organization is geared towards serving the client's needs and requests. Dovos has cultivated a culture where staff will do their best to fulfill a client request if at all possible.

The entire investment team, including the CIO, as well as the Back Office operations team is available to clients to interact with. This allows investment savvy private clients and professional institutional investors to get a deeper understanding of the Dovos investment strategy and how it fits their needs. While institutional clients are used to this service, private clients rarely get this level of exposure unless they are truly wealthy.

Dovos retains experts to conduct client seminars on finance related topics. In the past, this included topics around estate planning, insurance and major economic trends. These seminars are complimentary and the summary notes are available to anyone who was not able to attend.

2.6 Current Issues Facing the Company

There are a number of issues Dovos is facing at this time.

2.6.1.1 Declining Revenue and Profits

Dovos has experienced a decline in profit over the past 3 years. Customers have left at a higher rate than new customers were acquired. As a result, Dovos is managing fewer assets now than it has in the past. This is most apparent with the departure of large Institutional clients who represented a significant portion of the AUM.

Although the company is still profitable and will continue to be so in the near future, it is clear that the current trend is not sustainable. If it is not reversed, the company will not be able to meet its obligation to shareholders and it will have to be sold or face bankruptcy. The company owners have set a target of 30% margins.

2.6.1.2 Benchmark Focused Core Alpha Canadian Product Underperforming

The Benchmark Focused Core Alpha product, which has been one of the main pillars of the Dovos product lineup, has underperformed for the past 3 years. As a result, key Core Alpha customers have left and they account for over 94% of the AUM lost from 2011 to 2012. Additionally, the sales team has a very difficult time attracting new clients looking for Core Alpha. These models are shared between the different product lines, which means that portions of the Wealth Management product performance has also been weaker than many competitors.

The balanced mandate and the global mandates have both performed on par with average investment managers. This makes these mandates neither specifically attractive nor unattractive; however, it opens Dovos up to strong competition from top performers.

2.6.1.3 Demographic Risk from its Portfolio Managers Retiring

All of the current Portfolio Managers are nearing retirement age. Given that the Private Investment business is relationship driven, Dovos faces a massive risk of clients departing when the Portfolio Managers begin to retire.

2.6.1.4 Reinvestment into the Company

At this time, the shareholder directive is to pay out maximum possible dividend leaving little net income for re-investment into the company. This cash-cow approach has worked in the past. The question which has to be answered is whether this minimal re-investment policy is sustainable as the environment changes.

2.7 Summary

As demonstrated in this section, the current Dovos business strategy has experienced setbacks over the past two years and more importantly, it is open to further setbacks if no adjustments are made. When mapped onto a C*risis Curve* (Crossan, Rouse, Fry, & Killing, 2013), the urgency can be described as *Reactive*, given that the company is currently profitable. If the company strategy is not addressed, it will slide into *Crisis*.

The following section will examine the external environment in which Dovos operates and it will analyze how external forces are impacting the business future at Dovos.

3 Analysis of Factors External to the Company

3.1 Industry Overview

The industry definition is constrained to primarily Canadian clients who are looking for traditional investment services, implemented through Equity and Fixed Income. The two separate client segments of private individuals and institutions will be treated as belonging to one industry with relevant differences discussed where appropriate. Figure 3-1 shows the Canadian investment industry breakdown by client segments and their investments for institutional and private investors in 2012.

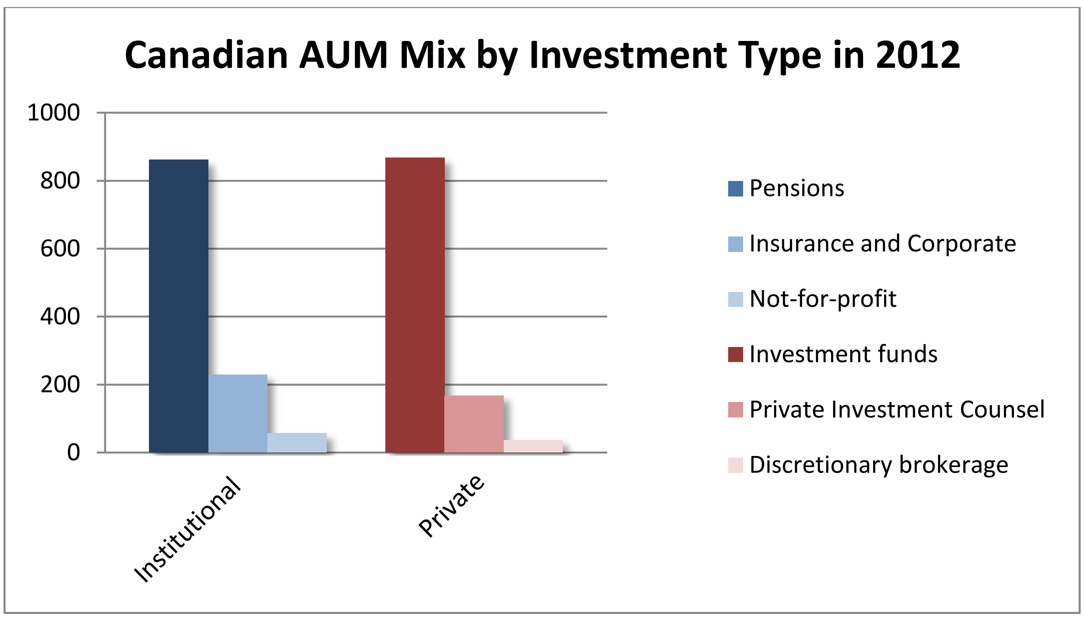

Figure 3-1: Canadian mix of AUM for institutional and private Clients. (Investor Economics, 2012) (Investor Economics, 2012)

Institutional and private sides are very close in size with $1,147 billion and $1,073 billion in invested assets respectively. The institutional clients are dominated by pensions while the private clients are dominated by investment funds also known as mutual funds.

3.1.1 Industry Structure

Suppliers	Competitors	Customers
Stock and Bond issuing organizations: Ex. IBM, Gov of Canada	Dovos Capital Management	Medium and High net worth individuals
Stock exchanges: Ex. TSX, NYSE	Banks and Credit Unions Ex. RBC Wealth Management, ING eSavings Account	Pension Funds and Foundations
Financial data vendors: Ex. S&P, Thomson Reuters, Bloomberg	Private Investment Counsel Firms Ex. Leith Wheeler	Large institutions looking for Specialist Investment Managers
Financial Research vendors: Ex. Axioma, Macquarie	Hedge Fund Investment Firms Ex. Front Street Capital	
Brokers: Ex. Goldman Sachs	Self directed investing Ex. iTrade, RBC Online	
Software and Service Vendors: Ex. ITG, Omgeo		
Custodians: Ex. Royal Bank Investment Services, Scotia Trust		
Banks: Ex. Royal Bank, TD		
Portfolio Manager: Ex. RBC Wealth Management		
Auditors and Lawyers: Ex. Ernst & Young, Borden Ladner Gervais		

Table 3-1: Industry overview. Source: Author.

Table 3-1 summarizes the industry structure by listing the suppliers, competitors and customer types. Each type is accompanied by some representative companies.

3.1.2 Industry Supply Chain

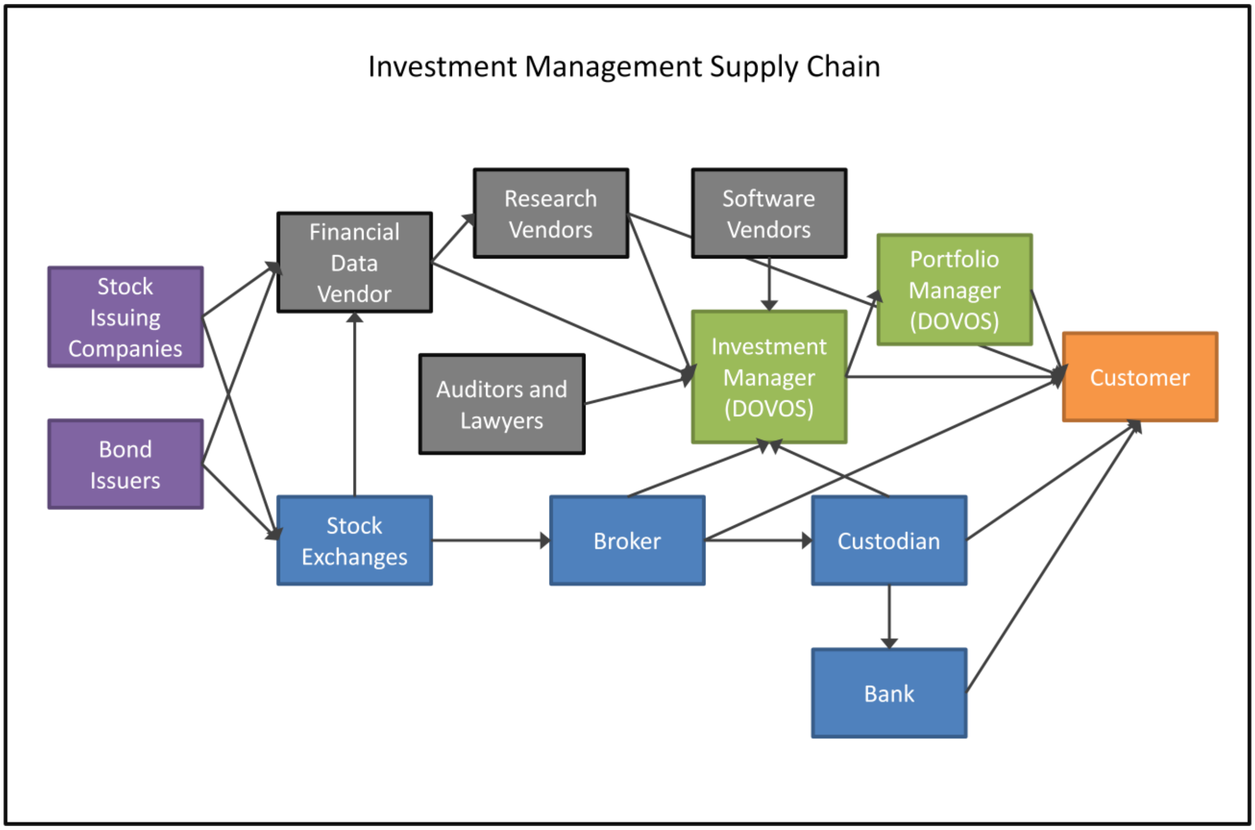

Figure 3-2: Industry supply chain. Source: Author.

Figure 3-2 illustrates the industry supply chain by showing how the different types of suppliers interact. The value chain starts on the left side with the industry's raw products and finishes on the right side with the customer. There are five major groupings. Primary investment vehicle manufacturers are in purple. Core trade service providers are in blue. Investment support services are in gray. Investment managers are in green. Customers are in orange. Each one of these categories is discussed in detail in the following sections.

3.2 Analysis of Competitors

The investment industry is highly competitive with a large number of competitors and product alternatives.

3.2.1 Competitor Composition

Investment managers in Canada can be segmented according to the size of their AUM. This division is illustrated by Figure 3-3.

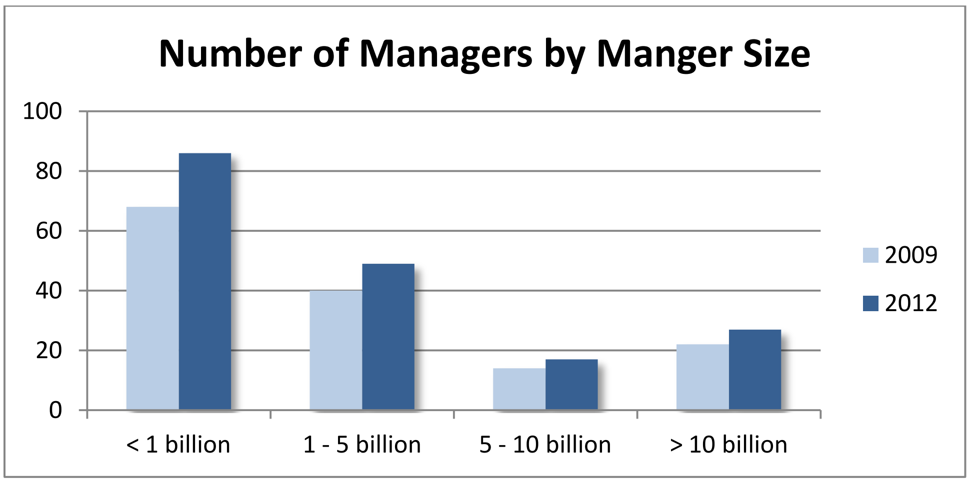

Figure 3-3: Number of investment managers by AUM in 2009 and 2012. (Investor Economics, 2012) (Investor Economics, 2012)

In 2012 there were 179 managers registered in total with 86 of them managing under $1 billion. Dovos fits in the second bucket with AUM between $1 billion and $5 billion and is one of 49 managers at that size. The relative market share of the managers by AUM size is illustrated by Figure 3-4.

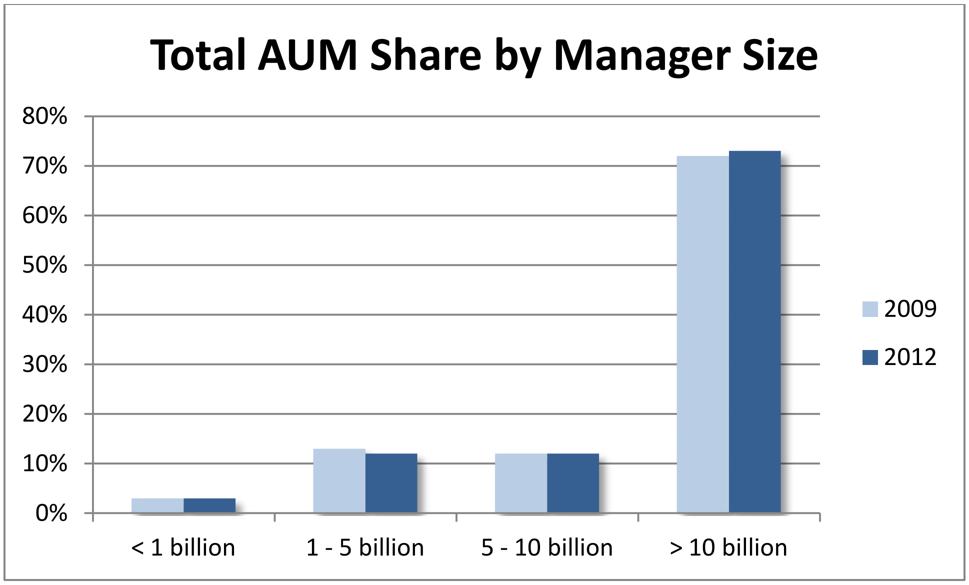

Figure 3-4: Total AUM share by manager size. (Investor Economics, 2012) (Investor Economics, 2012)

Overall the market share split has remained largely constant from 2009 to 2012, with the biggest managers taking some market share away from the 1-5 billion AUM companies. The increase in the total number of investment managers combined with the stagnant or decreasing market share for the Dovos sized firms indicates both an increase in competitive pressure and a difficulty in growing.

3.2.2 Competitor Strategic Grouping

The investment industry competitors can be grouped by category and compared against their AUM. Figure 3-5 shows the categories over time.

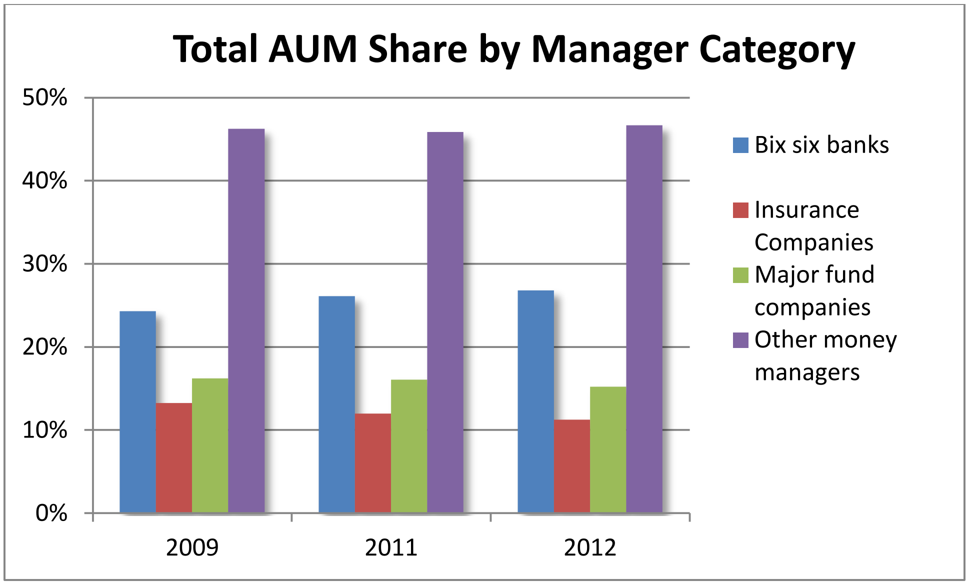

Figure 3-5: Total Canadian AUM share by manager category. (Investor Economics, 2012) (Investor Economics, 2012)

The largest category is "Other money managers" which includes companies like Dovos. This category has seen some growth in market share since 2009. The second largest category is composed of the six big Canadian banks: The National Bank of Canada, The Royal Bank of Canada, The Bank of Montreal, The Bank of Nova Scotia, The Canadian Imperial Bank of Commerce and TD Canada Trust. The big six banks category has seen the biggest growth of its market share since 2009.

3.2.3 Competitor Grouping Details

3.2.3.1 Big Six Banks, Other Banks and Credit Unions

Product	Wide variety of manufactured investment funds some of which may be outsourced. Distribution of other retail investment products as needed to fill own product gaps. Individual stock purchases. Basic savings accounts.
Services	Most other financial services such as financial planning, banking, loans, insurance. Little personalization except for the largest clients and private banking clients Larger banks offer self serve online investment portals
Access to Potential Investment Clients	High through other banking services.
Target Customers	Low to high net worth private investors and institutional investors.
Size	Large to very large.

3.2.3.2 Insurance Companies

Product	Typically own branded funds which are either manufactured or outsourced. Limited selection.
Services	Insurance and some Financial Planning. Little personalization.
Access to Potential Investment Clients	High by targeting existing insurance clients.
Target Customers	Low net worth private investors
Size	Medium to large

3.2.3.3 Major Fund Companies

Product	Wide variety of own branded funds which are either manufactured or outsourced. Typically no access to external investment product. Product is distributed by dedicated brokers and independent brokers.
Services	Financial Planning. Little personalization.
Access to Potential Investment Clients	Medium through dedicated and independent brokers.
Target Customers	Low to medium net worth private investors
Size	Medium to large

3.2.3.1 Independent Broker Investment Management Firms

Product	Reselling of a wide variety of 3rd party products manufactured by fund companies and independent investment management firms.
Services	Financial planning and frequently insurance, tax planning Little personalization.
Access to Potential Investment Clients	Low. Each new client has to be sourced or referred to the firm.
Target Customers	Low to medium net worth private investors
Size	Small to medium.

3.2.3.2 Independent Investment Management Firm

Product	Manufactured own investment product which is typically specialized to some niche. For example, Canadian Equity or Real Estate Income Trusts. Distribution of outsourced product to fill own product gaps. Distribution of own product through 3rd party independent brokers.
Services	Financial planning. Occasionally tax planning or insurance. High personalization often available.
Access to Potential Investment Clients	Low. Each new client has to be sourced or referred to the firm.
Target Customers	Medium to high net worth private investors
Size	Small to medium.

3.2.3.3 Alternative Investments

This broad category covers any other investment vehicles which may be used as an alternative to more traditional investments. It includes but is not limited to:

- Purchasing real estate
- Investing in private equity
- Offering direct loans
- Direct purchase of precious metals

While these are not competitor firms, all investment management firms compete with alternative investments for the customer's investable assets.

3.3 Analysis of Customers

All customers can be segmented along a set of common characteristics which can be used to evaluate their revenue potential. Through a careful analysis of each customer along these factors, the company can focus its resources on the customers which are most likely to generate maximum lifetime profit.

3.3.1 Customer Characteristics

3.3.1.1 Universal Customer Characteristics

Investment Requirements: The type of investment which is required by the customer. This is a critical determining factor in whether a given investment manager is able to satisfy a specific customer's requirement. If a manager does not offer the required product, there is no opportunity for a direct sale. There may, however, still be an opportunity for a referral to another firm.

Amount of Investible Assets: The amount of money a customer is able and willing to invest with the company. Given that the revenue for an investment firm is directly tied to the AUM, this is a very important factor in determining the lifetime value of the customer. At any given time, the account size is the primary distinguishing characteristic of all customers.

Support Needs: A broad category which captures the amount of effort that will be required to service the customer's requests, in addition to the actual work of investing the money. This effort can take different forms. For private customers, for example, this can be the customer's need to frequently discuss the investment policy. For institutional customers, this can take the form of the complexity of the reporting requirements or the number of meetings required annually. The Support Needs determine the resource drain a customer poses for the company which in turn determines the net revenue generated by the customer.

Asset Growth Potential: The predicted deposits to and withdrawals from the invested assets by the customer. For private individuals, this often reflects the client's earnings, potential for increased earnings over their career and motivation to invest their savings. For institutions, this reflects their contributions, donations or liabilities. The key aspect of this factor is its ability to predict the customer's asset size over time, which drives their lifetime value.

3.3.1.2 Private Individuals Customer Characteristics

This group covers private investors and families who are investing their own personal holdings.

Decision Makers: The family members themselves typically make the investment decisions; however, many private investors rely on the advice of trusted professionals such as accountants or lawyers.

Age Demographic: Private clients are often long term, or even life-time clients. The age demographic is an important factor governing how long the invested assets will stay with the company. Pre-retirement clients typically have their peak assets right before retirement, which means that the assets will be large at the beginning and then diminish over time. Middle aged and younger clients are still building their assets. The assets will typically be small at the beginning, increase over time as the client moves towards retirement age and then start diminishing again once they retire.

Inheritance Potential: This is a specialization of the Asset Growth Potential which covers customers who are likely to inherit significant investible assets in the future.

3.3.1.3 Foundations and Pension Funds Customer Characteristics

This broad group covers organizations which are charged with managing money that does not belong to the decision makers. This money is frequently assigned a specific purpose, such as the financing of a charity or the financing of retirement of the organization's members.

Decision Makers: The governing body of the organization, which is typically a board of directors, is the ultimate decision maker. These boards can be composed of volunteers or paid professionals and they frequently employ professional advisors to assist with the selection of the investment manager. This means that the investment reporting needs of the customers are typically complex.

Full Mandate or Specialist: This governs whether the investment manager is hired to manage a complete, multi-investment type mandate or whether it is hired to provide a specialized service. Full mandates are typically more valuable as the investment manager has more latitude with the customer and is more able to weather poor performance of specific investment components. With a full mandate, the manager can make adjustments to the complete portfolio to emphasize components which are performing well and de-emphasize components which are performing poorly. The customer is also more tied to the investment manager as they are providing the complete service.

With Specialist mandates, the manager is hired as a sub-contractor by another investment manager, internal or external to the client, to provide a very specific product. For example, the manager could be hired to provide a Canadian Equity Large Capitalization mandate. This specialized relationship is more volatile than a full mandate for two reasons. First, if that one component underperforms, then the sub-advising firm has no way of mitigating the underperformance. Second, the investing client has someone else in charge of the whole portfolio so it is easier for it to fire just the underperforming sub-advisor. For this reason, these specialist mandates are less valuable than full mandates.

3.3.1.4 Fund Companies, Insurance Companies, Banks Customer Characteristics

These companies are both competitors and customers in the investment management industry. For the purposes of client classification, all of these institutional investors can be grouped together. They all typically hire investment manager firms to sub-advise specific mandates and then they re-distribute these mandates to their end clients whose money is being invested.

These companies tend to be looking for investment product for fairly large mandates of anywhere from $50 million to $1 billion. They combine it with other products and redistribute it under their own brand. The relationship with the end client is completely removed from the sub-advising investment manager. Most of the time, the end client is not aware that their money has been outsourced to a sub-advisor.

These types of institutional clients tend to be sophisticated in their reporting and implementation needs and they tend to not be influenced by the relationship with the sub-advisor. If the product is not performing as well as anticipated, these clients will fire the sub-advisor with minimal notice.

Managed Assets or Separately Managed Assets (SMA): Managed Assets are the standard investment product where the sub-advising manager directly manages money and executes trades. SMA mandates, on the other hand, are portfolio recommendations to be executed by another investment team or broker. The relevant difference between these two is that with Managed Assets the manager is fully responsible for the portfolio performance while with the SMA mandates, the manager is only responsible for the performance of the theoretical paper portfolio.

The SMA mandates are popular with brokers who wish to be purchasing individual stocks for their clients instead of pooled funds, but who still wish to outsource the stock selection.

3.3.2 Customer Preferences Which Drive Purchasing Decisions

3.3.2.1 Universal Customer Preferences

There are a number of customer preferences which are common to all traditional investment customers

Investment Track Record: Investment performance is typically reported as annualized returns over long and short term investment horizons. Long term investment performance can be defined as covering more than seven years and shows a firm's performance through the ups and downs of the markets. Short term investment performance can be defined as covering one or two years and demonstrates how well a firm is able to navigate the present economic situation. While customers understand that past performance does not guarantee future performance, a good past performance track record is an indication of investment management skill which often influences future performance.

Trust: This customer preference is universal and it is difficult to quantify. Fundamentally, an investment customer must trust their investment services provider. For private individuals, this often comes from having the investment manager referred to them by a friend or professional acquaintance. For the decision makers at institutional customers, the trust can come from a referral, from the advice of a professional advisor or through a personal relationship with someone at the investment manager.

Investment Product Suitability: All investment customers have goals for their investments and a personal preference of how to achieve those goals. The most fundamental preferences or characteristics are

- **Time Horizon:** How long the money can stay invested before it has to be redeemed.
- **Risk Tolerance:** How much in losses the customer is willing to accept in order to attempt higher returns. This characteristic is often related to the Time Horizon.
- **Yield from Investment:** How much income needs to be generated annually from the investment. This is particularly important to clients with specific liabilities such as pension funds, foundations or retirees.
- **Target Return and Benchmark:** What return on investment is considered a success and whether the returns are considered in absolute terms or relative to some benchmark. This characteristic is frequently tied to Risk Tolerance.

There are also specialist product preferences which are driven by a customer's individual preferences, the composition of the entirety of their portfolio or direction from an institution's board.

- **Type of Underlying Investable Asset:** Whether an investment is classic securities such as stocks or bonds, derivative securities such as futures or tangible assets such as real-estate.
- **Geography of Underlying Investable Asset:** The countries or regions which are the primary residences for the risk and returns associated with the asset.
- **Tax Implications:** Does the investment have to have specific characteristics based on tax requirements.
- **Liquidity of Investment:** The time required to redeem the investment if the need arises and retrieve the invested cash. Some customers are willing to risk being unable to liquidate their assets for months or years, while others wish to have the ability to redeem in days.

Customers often have a predetermined preference for a very specific product. In many cases it is possible to break down the preference into its underlying components and to satisfy the customer needs with slightly different products which still meet the core requirements.

Private individuals are typically most flexible on the specific product, as long as their core requirements are met, while institutions outsourcing the investment of a part of their portfolio are least flexible. When an institution is looking for a sub-contractor investment manager, they are typically looking to fill a very specific gap in their own lineup.

Degree of Product Specialization: Once the fundamental characteristics of a product are met, many individual investors and all institutional investors require a degree of customization of their portfolio to meet their specific needs. For foundations and pension funds this is especially important given their commitments and liabilities and often takes the form of a requirement for a specific annual yield, or the requirement for the portfolio to track the market to a specified, quantitative value.

Ease of Use and Personalized Service Quality: All customers care about service to some degree, however, private investors care much more about service flexibility than institutions. People often have unique and unpredictable needs such as requiring a withdrawal on short notice in a specific currency, or requiring handholding through a difficult time such as dealing with an inheritance. Institutions, on the other hand, tend to have more predictable needs which do not require this level of personalized service.

The service preference also includes the fundamental requirement of accuracy and service correctness. Mistakes made by the investment service provider can be costly and very inconvenient. For example, if a request for a withdrawal is not processed correctly and the money does not arrive on the requested date, a customer can face significant problems.

The other side of service is the ease of access to the service. This includes hours of operation and availability of people to speak with in person and remotely. Hours of operation are valued by private individuals much more than by institutions, given that institutions are typically represented by employees who wish to operate during regular business hours.

The availability of people to speak with in person is valued equally by all customers. All customers, including institutions, require update meetings and they value opportunities to interact with the investment decision makers.

3.3.2.2 Private Investor Customer Preferences

Availability of Other Financial Services: This is an extension of the ease of use preference. Private individuals require a multitude of financial services including tax planning, loans and insurance. Being able to get multiple services from one provider makes the customer's life easier.

Added Value Service Intangibles: This is a very broad category and it captures any additional service that an investment manager can chose to provide. These will typically not dominate a purchase decision, however, they can add to a customer's choice to stay or leave. This category includes the extra items such as tea and coffee served at investment review meetings, clarity of reports or politeness of the front desk staff.

3.3.2.3 Institutional Investor Customer Preferences

Reporting Flexibility and Robustness: While all customers care about their financial statements and reports, institutions have very strict requirements which are much less flexible than individual investors. Institutional investment financial statements are reviewed by many different people, ranging from board members to accountants and auditors, with different needs and financial literacy levels. An institution may not hire an investment manager if it cannot deliver the right set of reports at the right times.

3.3.3 Customer Segment Size and Growth Trends

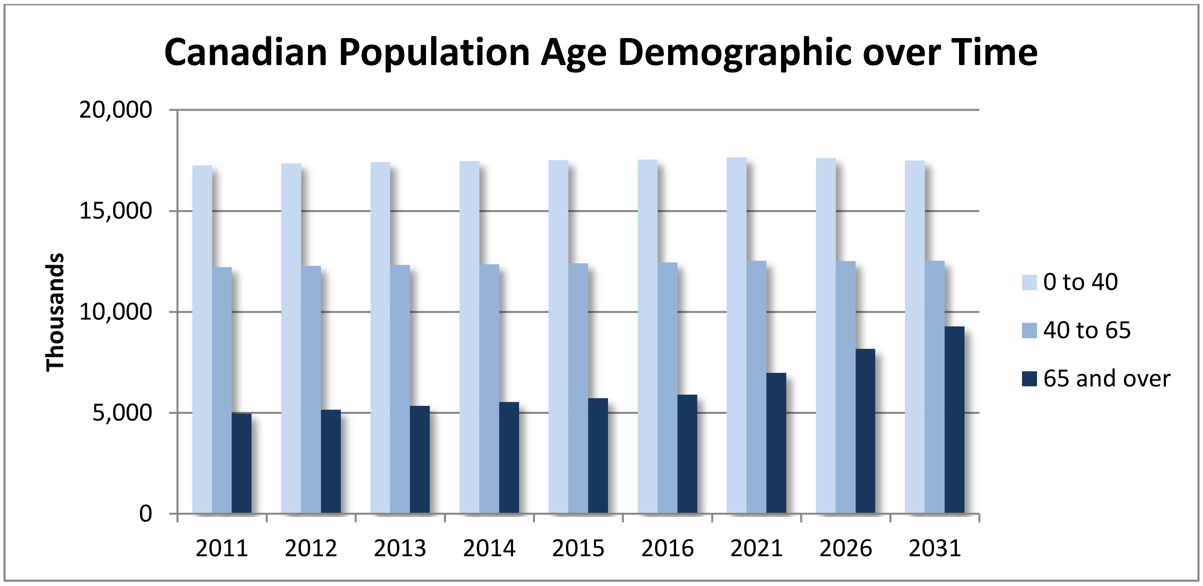

Figure 3-6: Canadian population age demographic over time. (Statistics Canada, 2010) (Statistics Canada, 2010)

The most significant trend for investment customers is the aging of population which impacts both private investors and institutional investors. Figure 3-6 shows the predicted age demographic breakdown of the Canadian population up to the year 2031. Private investors are impacted directly as they get older and their investment needs change. Institutional investors are impacted indirectly through the aging of their customers whose money is being invested. Pension funds are facing an increased pressure of withdrawals while the numbers of contributing members are declining.

The effect of this trend on both segments is very similar. There is a constantly increasing demand for investment product which is built for safe, less volatile and consistent returns at the cost of lower returns.

3.4 Analysis of Suppliers

Investment management industry suppliers can be divided into the groups discussed below.

3.4.1.1 Primary Investment Vehicle Manufacturers

Stock, bond and commercial mortgage issuing organizations, primarily corporations, banks and governments, make up this category. Stocks, bonds and commercial mortgages are not available for purchase by the investing client directly from the issuer.

3.4.1.2 Core Trade Service Providers

This category is comprised of suppliers which are necessary for the purchase and sale of securities. All purchasers of securities must use this supply chain to trade securities and to distribute dividends and other yield.

In very simplified terms, companies issue securities to be listed on security exchanges. A security purchaser places an order with a broker who then executes the order on the security exchange by matching the buyers and sellers. The security itself is placed in a custodian account for holding and the funds necessary to execute the order are transferred to and from a bank account.

The actual process of executing the transaction is complex and can involve trading after hours on secondary exchanges and securities lending for short-selling stocks. The key service that a broker provides is matching the buyers with the sellers. A single buyer and a single seller will almost never wish to transact on the exact same amount of securities. A key service that the brokers provide is matching a seller with a number of buyers or a buyer with a number of sellers to fill the order.

The custodian acts as a record keeper and vault for the client since the client no longer gets a physical stock or bond to hold at home and all standard trading is electronic. A custodian provides the key service of holding securities in their client's name. This allows trades to happen very quickly as there is no physical object which needs to be transferred from one owner to the next.

Banks act as a final link in the service provider chain by holding the client's money in their account and providing general banking services to the buyers and sellers.

3.4.1.3 Investment Support Services

The suppliers in this category provide important but ultimately optional services to both the investment manager and to the client directly. None of these services are strictly necessary for the execution of trading and investing, however, they are essential for operating efficiently and making sound investment decisions.

Companies like Bloomberg, Standard and Poors and Thomson Reuters gather and report financial and trade data on companies and securities. This data is packaged and delivered to the researchers and investment managers. These companies also provide security identifiers which are critical in addressing the securities. Standard and Poors, for example, administers CUSIPs which are the standard identifier for North American stocks. It is nearly impossible to trade securities at a professional level without some globally recognized 3rd party identifier.

In addition to investment managers, financial analysts such as Macquarie consume financial data and attempt to forecast the future. These forecasts are sold to both, investment managers and individual investors.

Software vendors provide the tools which are necessary for modern trading. In addition to fundamental software needed for all modern businesses, such as operating systems and word processors, there is a number of highly specialized software systems used for investment management. These systems cover all of the key functions: data analysis, portfolio construction, trade submission, accounting, client relationship management and client reporting.

Finally, auditors and lawyers provide the legal and administrative framework which allows investment managers to operate in the highly regulated investment industry.

3.5 Analysis of Forces Driving the Industry

Force	Who	Assessment Summary
Suppliers	• Issuers • Stock Exchanges • Brokers • Custodians • Banks • Data Vendors • Research Vendors • Software Vendors • Auditors, Lawyers	**HIGH** + Impossible to trade stocks without the stock exchanges, brokers, custodians and banks + There are no real alternatives to the big exchanges like NYSE or TSX + Specialized software and data has large switching costs - Broker services are commodity and so tend to compete on price
Buyers	• High net worth individuals • Institutions	**MEDIUM** + easy to compare results + low switching costs - long term relationships difficult to break (trust) especially for individuals - significant information asymmetry as it is easy to hide true costs and make it difficult for customer to compare price - private clients tend to not truly understand the product and so can be easily confused

Rivalry	• Independent investment counsel firms • Bank affiliated investment counsel firms	**MEDIUM** + Most potential customers already have an investment solution, so they have to be taken from other investment firms. + Price competition from Bank based firms with massive scale + A lot of choice of investment managers + Overall market growth is stagnant with little new assets to manage. - Some ability to differentiate products by investment methodology and underlying investment vehicle as well as by performance track-record. - Low barrier to exit
Threat of New Entrants	• New firms	**MEDIUM** **-** Building trust with new clients a barrier to entry + Relatively easy to set up a new company + Some existing relationships can be converted (ex. Insurance companies) - Track record takes time to establish
Substitutes	• Self directed investing • Government investments (GICs) • Alternative investments such as precious metals or real estate	**MEDIUM** + Easy for people to self invest online + Many investment alternatives to stocks and bonds. - Many people are not comfortable making their own investment decisions - Investing well is time consuming

Table 3-2: Forces driving the industry. Source: Adapted by Author.

Table 3-2 shows the summary of the forces driving the industry using the “5 Forces” framework (Porter, 2008) (Porter, 2008). Each force is discussed in detail below.

3.5.1.1 Power of Suppliers

Stock exchanges have significant power. There are few alternatives to the big exchanges such as NYSE and NASDAQ in the US and TSX in Canada. Due to strong network effects, companies will wish to be listed on the biggest exchange that they can qualify for, which in turn leads to consolidation and the formation of few, dominant monopolistic exchanges. Investors, who wish to buy a specific stock, have no choice as to which exchange they interact with. NYSE dominates the exchanges with a 2011 trade value of more than 20,000 billion USD, the second largest exchange, NASDAQ had a trade value of more than 13,500 billion USD and the third, the Tokyo Stock Exchange had a trade value of just less than 4,000 billion USD. (World-Stock-Exchanges.net, 2012)

Brokers do not have significant power when dealing with investment managers because the managers have contracts with multiple brokers and can easily compare their rates. Additionally, the broker's primary service is hard to differentiate. Speed and quality of execution does come into play, however, these are typically very similar amongst brokers. Furthermore, since the advent of discount brokers who offer stripped down service at the lowest price possible, the brokerage business has moved to competing on price.

Custodians and Banks are a commodity business, but there can be a significant switching cost for an investment firm due to deep process integration. While custodians and banks try to compete on service and differentiation, in reality it is very difficult for them to compete on anything other than price. As long as they deliver basic, accurate service, the investment firms only care about the price.

Financial Data providers have power and primarily compete on differentiated quality. High quality, timely data can be a significant advantage to investment managers which makes them reluctant to settle for lower quality, cheaper data. Additionally, the majority of cost for financial data distribution is fixed as it is tied to the gathering and storing of the data. This makes the MES quite high resulting in a small number of large, dominant financial data providers: Standard & Poors, Thomson Reuters and Bloomberg.

The software service providers have moderate power depending on their particular product. The biggest power of the software manufacturer comes from switching costs, which cover both the costs of reconfiguring systems to interface with the new software and the costs of training staff. The supplier of a fully integrated, complex and critical system such as the trading system has significant power over the investment manager due to the high switching costs. A full system switch can take one to two years to fully roll out. This effect is tapered by the relatively small pool of possible clients. Given that this software is only usable in this industry, each specific client lost is difficult to replace.

3.5.1.2 Power of Buyers

Buyers are a medium force in this industry. On one hand, the buyers are completely fragmented as each individual investor makes their own choice; on the other hand, the buyers have great access to information. With the advent of the internet, it has become very simple for buyers to quickly compare the different investment options for the actual returns versus the industry standards. Comparing prices remains difficult due to many hidden costs of investing. For example, some investment managers charge a fully inclusive price, while others make the client pay for custody and trade costs.

On average, buyers are more educated about the investment industry now than they were previously thanks to a proliferation of investment advice websites and TV shows. At the same time, the investment industry is quite complex and many private investors are still quite unfamiliar with its various complexities. The net effect is that while the average private investor is more sophisticated than they were previously, they can still be taken advantage of by unscrupulous investment managers.

Individual investor buyers have little bargaining power with the investment manager until their investable assets reach multiple millions. Institutional investors tend to command large assets consisting of tens of millions and so have significant bargaining power.

Finally, the switching costs for buyers are low. The actual act of switching from one investment manager to another is essentially free for the investor. All of the switching costs are incurred before the switch and take the form of search and selection costs. The investor is constrained by two main forces: the fear of making a costly mistake and a personal relationship with the investment manager. Both of these are a form of switching costs and they can be significant. Even though investment clients can switch their managers frequently and they can hunt for best pricing, the majority of clients prefer to stick with their managers for many years.

3.5.1.3 Rivalry

The force of rivalry is medium; however, it is trending higher. There are many competitors ranging from very small investment managers operating with one or two staff and servicing fewer than a hundred clients all the way to very large bank based investment managers servicing many thousands of clients.

Globally, the amount of assets available for Investment managers to manage is growing at a very small rate when compared to the market value change. Figure 3-7 shows that over the period from 2008 to 2011, the average net asset flow was only 0.6%.

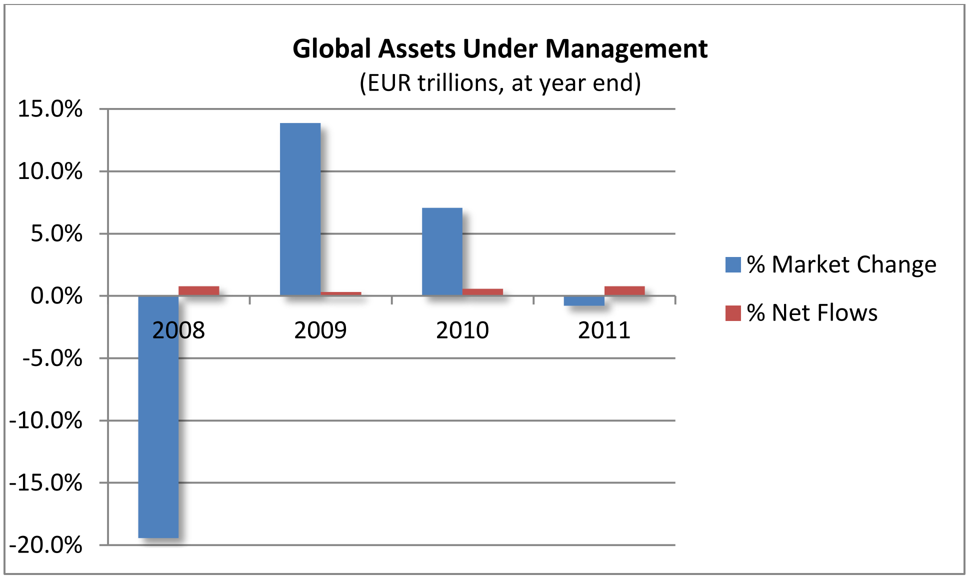

Figure 3-7: Global assets under management over time. (McKinsey & Company, 2012) (McKinsey & Company, 2012)

This effect can also be seen when assets available to investment managers are compared against global financial assets as show in Figure 3-8.

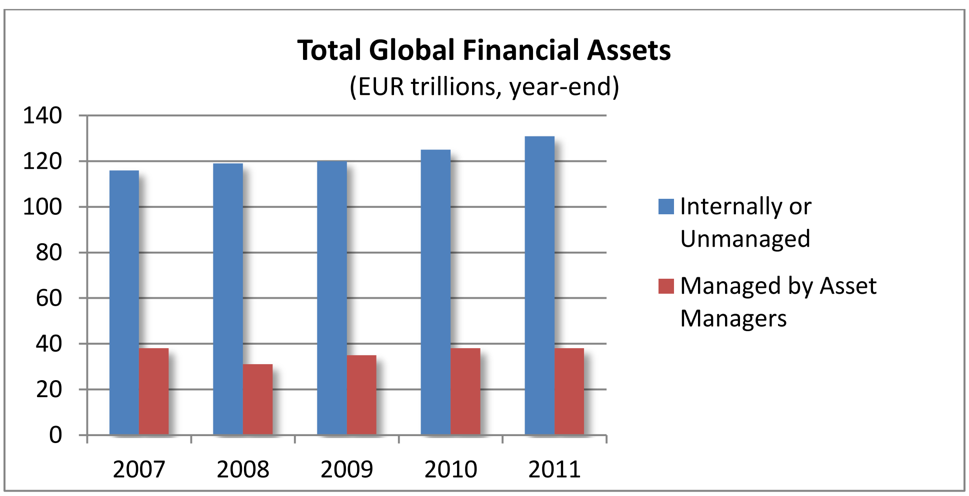

Figure 3-8: Total global financial assets over time. (McKinsey & Company, 2012) (McKinsey & Company, 2012)

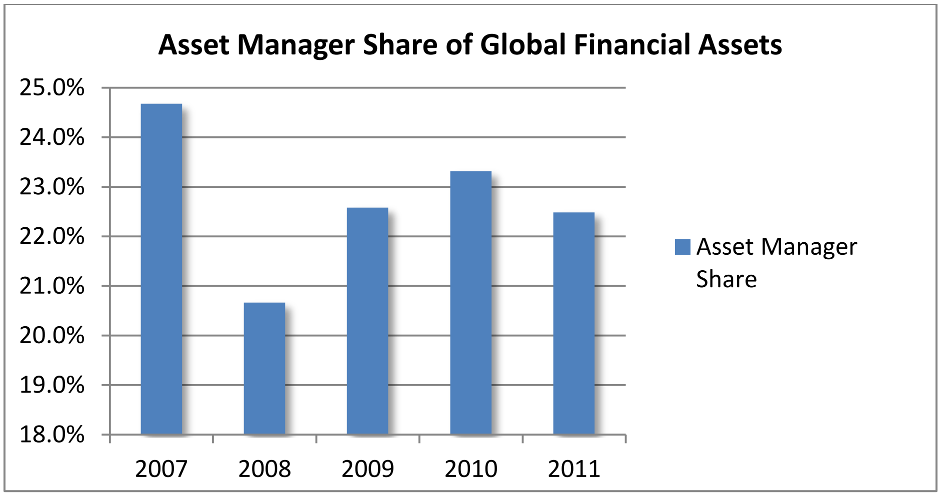

Figure 3-9: Investment manager share of global financial assets. (McKinsey & Company, 2012) (McKinsey & Company, 2012)

Figure 3-9 shows the share of global financial assets which are available to investment managers. While global financial assets have grown, the amount of assets available for investment managers has not kept pace. In fact, the percentage share of these assets has decreased considerably from 2007. This means that the only way for investment managers to grow their asset pool is by taking those assets away from other managers. Furthermore, most potential private clients with investible assets and virtually all institutional clients, already have an investment manager who provides them with service. In order to acquire a new client, an investment manager must steal the client from another firm. By far and large, this industry is a zero sum game.

Economies of scale in the industry allow banks and other large organizations to compete on price as well as on other factors. Banks are able to push the prices down forcing the smaller managers to either match or to work hard on differentiating themselves along the customer preferences. This effect is mitigated by the information asymmetry discussed in the preceding section as it is difficult for customers to objectively compare prices.

Investment managers attempt to carve out their own identities in a crowded market, however, they typically end up sounding very similar to each other. As a result, product differentiation does not significantly reduce rivalry. Instead, relationship driven sales reduce rivalry, making it difficult for competing firms to steal each other's clients.

One final consideration is that the barriers to exit are low because there is great stored value in the private client pool. The client base can be sold to a competitor on exit. Time and money spent on advertising, building a track record and acquiring clients can then be recovered through a sale of the client book as if it was a tangible asset which significantly reduces sunk costs. This means that underperforming companies can easily exit the industry instead of being forced to compete at all costs. It is important to note, however, that the sunk costs can become recoverable only after a company has successfully built a client book which can take considerable time.

3.5.1.4 Threat of New Entrants

The force of threat of new entrants is medium. Starting a firm as such is relatively easy and the direct barriers to entry are low. In the simplest terms, a new investment manager needs to have employees with the required certifications such as Chartered Financial Analyst (CFA) or equivalent and then register with the regional Securities Commission. This process typically takes a couple of months. A new investment manager can design and implement client portfolios with minimal infrastructure through web-based portals which keeps the initial capital investment very low.

Post 2008 financial crisis, the regulatory requirements are a noticeable barrier to entry. Any new firm must invest resources in compliance staff and systems in order to meet its regulatory obligations. Technology is a mitigating factor as there are excellent, off the shelf compliance systems which a company can purchase. Overcoming the regulatory barrier is simply a matter of making sufficient capital investments.

The real barrier to entry is attracting clients. What makes attracting clients difficult is that client relationships are long-term in nature and it is essentially impossible for a client to try the service like they might try a one-off consumable. Signing on with a new investment manager is a major, long term decision. These long-term relationship based sales require a level of trust or a multi-year performance track record which takes time to build. This reduces the strength of the force "threat of new entrants". It takes time for start-up firms to acquire clients, which in turn makes it difficult for people with no client relationships to start a new firm.

3.5.1.5 Threat of Substitutions

The force of threat of substitutes is medium in this industry. The internet and the proliferation of online discount brokers has allowed the customer to invest their assets directly thereby circumventing the investment manager altogether. Also, the same changes have allowed the customer to invest in other types of investments in addition to traditional stocks and bonds. In recent years, there has been a proliferation of easily accessible alternative investments such as specialist Exchange Traded Funds focusing on specific industries, commodity investments, precious metals, real estate funds and personal real estate investments. Recent market instability has given some clients the necessary incentive to change their approach and to abandon traditional stock and bond portfolios in favor of the alternatives.

The main deterrent to moving money out from a traditional investment manager to one of these newer alternatives is the client's personal time. Taking care of your investments requires significant commitment which many people want to avoid. There is also a psychological aspect of the client having to possess the confidence to invest in something different or to try unpracticed techniques with their own personal savings.

3.6 Sources of Competitive Advantage

Sources of Advantage can be examined from two perspectives: the customer's *willingness to pay* and *price effects* (Ghemawat, 2010). The willingness to pay is based on meeting customer's needs and the price effects are based on reducing the company's costs. By mapping a company's sources of advantage onto customer's needs and cost reducing strategies, a company can be evaluated against its competitors on how well it is able to attract clients and keep its costs down. This can then be used to assess the overall company competitiveness.

Table 3-3 scores the customer needs on their relative importance to the customer's decision making process and it scores the company's advantages, including those impacting costs, on their importance. The scoring is on a scale from 1 to 5, with 5 being most important or impactful. The cost advantages do not have a customer importance score as the customers do not care about a firm's internal costs. The cost advantages are purely for the company's ability to compete on price or to extract superior profits.

Two representative firms were chosen to compare against Dovos: Royal Bank of Canada Wealth Management representing very large investment companies and banks and Ladner, Thomson & Associates, a two person company, representing very small independent investment companies.

Willingness to Pay and Source of Advantage	Relative Importance to Customer	Dovos	Major Bank: RBC Wealth Management	Small Private Counsel Firm: Ladner, Thomson & Associates
All Customer Types				
Likelihood of superior future investment performance	5			
Long term performance track record	4	3	3	4
Short term performance track record	5	2	3	3
Stable investment team	3	4	2	3
Large investment team	2	3	5	1
Investment product selection	3			
Wide range of product offerings	3	3	4	1
Investment safety and risk reduction	4			
Years in business	3	4	5	3
Firm integrity record	4	4	4	4
Firm professionalism	4	4	5	3
Familiarity with firm	4	1	5	1
Firm transparency	3	4	2	5
Ability to have true segregated portfolios	3	4	4	3
Investment customization to specific investment needs	4			
Customized portfolios	4	4	3	3
Private Investor Needs				
Service	3			
Strong personal relationship	4	4	2	5
High ratio of staff to clients	3	4	2	4
Flexibility to requests	3	4	2	5
Multiple convenient locations	4	1	4	1
Online services	3	1	4	1
Breadth of financial services	3			
Fully featured financial office	3	3	5	2
Institutional Investor Needs				
Ability to meet reporting requirements	4			

Flexibility to reporting requests	4	4	3	2
Cost Advantages				
Economies of scale		2	5	3
Economies of scope		2	5	1
Optimal capacity utilization		2	3	5

Table 3-3: Sources of competitive advantage. Source: Author.

3.6.1 Customer Utility and Willingness to Pay Advantages

3.6.1.1 Likelihood of Superior Future Investment Performance

Fundamentally customers want to invest with investment managers who will generate superior future returns or meet their income needs. The only hint at how the unknown future may be handled by a company is by examining how it handled the past.

Good long term investment performance, defined as longer than 7 years, can be a significant advantage to an investment company since it is a time dependent resource. There is no way to accelerate the building of a multi-year track record. Dovos and RBCWM both have comparable long-term track records with LTA having a slight performance advantage. This kind of advantage is necessary for companies like LTA in order to survive over the long term.

Short term investment performance, defined as shorter than 3 years, is an even more significant advantage to investment companies as it gives the clients the impression that the investment company is completely in tune with what is happening now. There is an industry effect of some investors chasing after “hot numbers” and moving assets to investment managers who have had superior results in the past couple of years. Dovos is at a slight disadvantage in this important category due to its inferior core Canadian Alpha product performance, which is only partially mitigated by its slightly above average balanced and global mandate performance. Both RBCWM and LTA are essentially on par. It is worth noting that very few investment management firms retain superior short term performance for extended, multi-year periods of time.

Regardless of how good a track record is, it will have little value to the customer if the people responsible for making the investment decisions are no longer with the firm. The stability of the investment team is an important part of a customer's decision making process. Smaller firms like Dovos have an advantage over big banks because the investment professionals making the investment decisions are accessible to the clients and can be shown to be unchanged. Additionally, both Dovos and LTA were founded by their current chief investment strategists who are not only still with their respective firms, but are very unlikely to leave. With RBCWM's investments, on the other hand, the investment strategists for the different funds and products rotate periodically and can leave without much notice to the client. It is important to note that this advantage can become a disadvantage if the founders retire without grooming a trusted and competent successor.

Great performance often requires a great research team in addition to the chief investment strategist. When compared against other small investment managers, Dovos has the advantage of having a dedicated investment technology and research team while LTA has no technology or research team apart from their one Portfolio Manager. Big banks and larger investment managers, on the other hand, have very large teams which give them an advantage over Dovos and LTA. It is important to note that the teams are an advantage only when they yield superior investment performance results.

3.6.1.2 Investment Product Selection

RBCWM and other big banks can offer a wide selection of products which can be unavailable through smaller firms. Smaller firms do not manage sufficient assets to diversify into many different products efficiently and so they are forced to be specialists and outsource to sub-advisors to create selection.

Dovos is at a disadvantage to RBCWM as it specializes in equity investments with sub-advisors for fixed income and Emerging Markets investments.

3.6.1.3 Investment Safety and Risk Reduction

This customer utility item is focused on avoiding investment losses from intended malicious action such as fraud and from unintended mistakes such as firm bankruptcies.

Any firm that has been in business for over twenty years is more appealing to customer's concerns for safety and stability than a newly formed firm. Similarly to long investment track records, this is a time dependent resource. Firm reputation is derived from its actions and stability over time. There is no way to accelerate the building of reputation. Dovos, RBCWM and LTA all enjoy strong, long term reputations, with the bank having a clear advantage over other private firms given its over 100 years of history. This also ties into the perception of professionalism of the firms. Centuries old banks, by their very nature, convey an air of stability and professionalism which small firms cannot duplicate.

Banks also enjoy a unique advantage over firms like Dovos in that they already have a relationship with their customers through standard banking services. Every existing bank customer can be easily approached with investment product. Dovos and LTA, on the other hand, have to first make potential customers aware of their existence and only then they can try to make a sale.

One area where smaller firms like Dovos and LTA can enjoy an advantage over RBCWM is in having greater transparency. Clients can see the inner workings of the operation, meet everyone involved in the investment process and see the whole company from the inside. A big bank does not allow typical customers to interact with their back office staff in the same way a small firm can. Some clients feel more secure in knowing the people who actually take care of their money in addition to knowing just the sales representatives. A small firm like LTA can chose to be even more transparent than Dovos because its two person operation is naturally less complex and more understandable than Dovos'.

True segregated portfolios where the customers are owners on record of all their securities give customers protection from firm bankruptcies and other financial disruptions. All investment firms can open segregated accounts for their clients; however, larger firms can negotiate better rates with custodians. LTA's customers, for example, have to either agree to pay a higher custody fee or be forced to not have true segregated assets.

While these advantages are most relevant for private investors, institutions are not immune. All institutional customers are represented by people who also need to know and trust the investment managers they hire.

3.6.1.4 Investment Customization to Specialized Needs

Smaller sized firms can be more flexible for smaller customers than big banks. A customer is more likely to select an investment manager who can match their needs exactly, which makes flexibility important. The economies of scale for banks push their investment professionals to offer standard solutions, which may not be ideal when dealing with relatively small customers. Dovos, on the other hand, can offer specialization to these smaller investors. As long as the product selection itself meets the customer's needs, Dovos can offer more customization than RBCWM. LTA, however, faces a different problem altogether. With only two staff, LTA is too small to offer much customization to customers because it just does not have the necessary resources. Dovos enjoys a unique size advantage by being large enough to have the necessary staff and investment research infrastructure to provide customization while at the same time being small enough to not require standardization in order to take advantage of scale cost savings.

3.6.1.5 Private Investor Needs - Service

Very small and focused firms like LTA have an advantage over other companies in the strength of relationships that they can forge. With fewer total customers and the customers being serviced by the firm founders directly, LTA can develop even deeper bonds than a company like Dovos or a bank like RBCWM. This is a significant advantage given that private individuals value relationships highly.

A related aspect of this effect is the higher number of service employees for each client and the non-bureaucratic environment that smaller companies like Dovos and LTA can offer. Unlike RBCWM, there are no major scale efficiencies which will be lost by processing unique requests. Additionally, Dovos and LTA both enjoy the advantage of having experienced client service staff. Since big banks tend to have more junior staff, especially when dealing with smaller accounts, customer experience can suffer. LTA can provide great service, however, due to its small size it can be swamped by multiple specialized customer requests.

Accessibility is the other aspect of service valued by individuals. Here RBCWM is at a clear advantage compared to Dovos and LTA as it offers many conveniently located branches while Dovos and LTA both have limited offices. Also, RBCWM has developed a robust online investment platform which allows their customers to self-service many requests while Dovos and LTA can deliver only a rudimentary online experience.

3.6.1.6 Private Investor Needs - Financial Services Breadth

A big bank like RBCWM can offer all financial services under one roof making the overall customer experience simpler and often with bundled pricing. Dovos and LTA both must use referrals to match this, which when used well can offset the disadvantage. By offering to connect its clients with other independent financial services, Dovos and LTA can expose their clients to "best of breed" financial services instead of just one bank's services. Given that most clients value ease of use over always getting the best possible service, however, RBCWM has an overall advantage.

3.6.1.7 Institutional Investor Needs - Ability to Meet Reporting Requirements

Similarly to service, Dovos enjoys a slight advantage over RBCWM given its higher potential for flexibility. For the largest customers, however, RBCWM's size can give it an advantage if the reporting needs are very onerous. Dovos and LTA may not have the capacity to meet particularly voluminous requirements. LTA is the most disadvantaged as it lacks the resources to produce many complicated and customized reports.

3.6.2 Cost Advantages

3.6.2.1 Economies of Scale

The biggest cost advantage RBCWM has is the scale of its operation. RBCWM has much more AUM than Dovos and can open its offices across the world in cost efficient locales. All of the fixed costs for managing money, including registration costs and research costs are diluted over many more customers. Dovos and especially LTA are not able to match this potential for cost reduction.

The second aspect of RBCWM's scale advantage is the access to best rates based on volume. RBCWM gets better rates from financial suppliers such as brokers and data vendors and from standard suppliers such as hardware vendors simply because they are purchasing much more volume than Dovos or LTA.

3.6.2.2 Economies of Scope

RBCWM offers many different services which allow them to save costs. For example, all investment managers have increased work during quarter ends and an extra large amount of work during year end. A bank is able to shift some of its workforce to supporting other departments between quarters in a way that Dovos or LTA cannot. Additionally, RBCWM can share infrastructure costs such as buildings, IT and corporate administration between its different banking and investment products.

3.6.2.3 Optimal Capacity Utilization

LTA enjoys an advantage over Dovos in its ability to fully utilize its capacity and infrastructure. It is able to not only keep its operations very small and simple with only two employees, it has been able to grow its business so that this infrastructure is fully utilized. LTA has no real capacity to grow without adding to its operations, however, that means it currently has very low cost to AUM ratio. Dovos, on the other hand, has 27 employees and rents a larger office with more equipment, more complex IT systems and purchases more investment research data. It is set up for growth and it is capable of managing more than double of its current assets.

In effect, LTA is operating at near its minimum efficient scale for the simpler investment product that it offers, while Dovos is geared for the next level of investment complexity and scale, but it has not reached the necessary output. Dovos' only advantage in scale comes from the fixed costs which have to be paid by all investment managers, including registration and legal.

3.6.2.4 Dovos' Cost Position

In order to combat all the disadvantages above, Dovos has been very consciously keeping its costs as low as possible through minimal staffing, no frills office and median salary levels.

3.7 Dominant Industry Trends

There are two major trends shaping the industry.

3.7.1 Trend of Declining Profitability

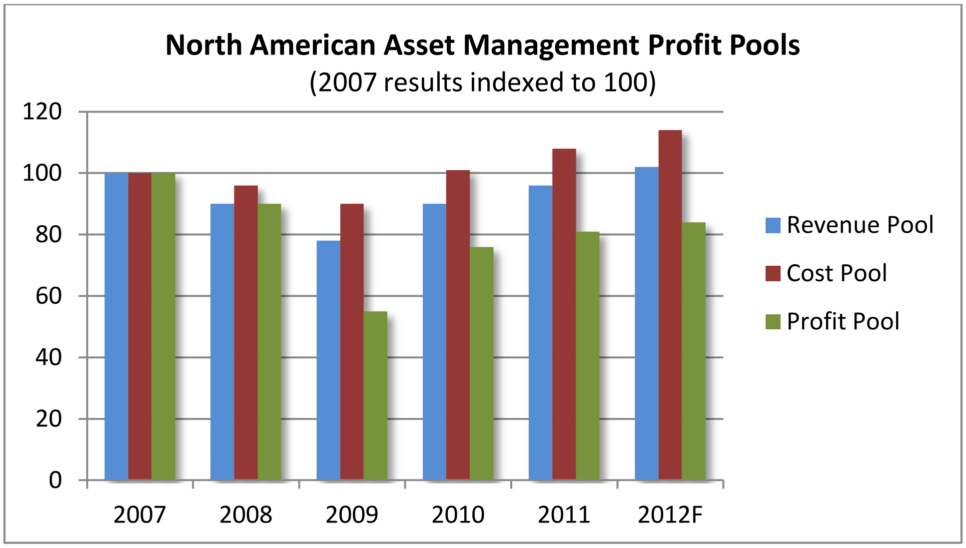

Figure 3-10: North American investment management profit pools over time. (McKinsey & Company, 2012) (McKinsey & Company, 2012)

When investment management revenue, costs and profits are mapped in Figure 3-10 over the period from 2007 to 2012(forecast), it is clear that while the revenue has recovered to its 2007 level, the costs have surpassed those levels. Consequently, profits have not recovered.

This can be partially attributed to additional reporting and regulatory requirements imposed on the investment industry post the 2008 financial crisis. Before 2008, Dovos was able to meet its regulatory requirements with one employee dedicating less than one half of her time to compliance. In 2012, this had to be increased to one fulltime and one part time employee.

3.7.2 Trend of Stagnant Developed Markets and Growing Emerging Markets

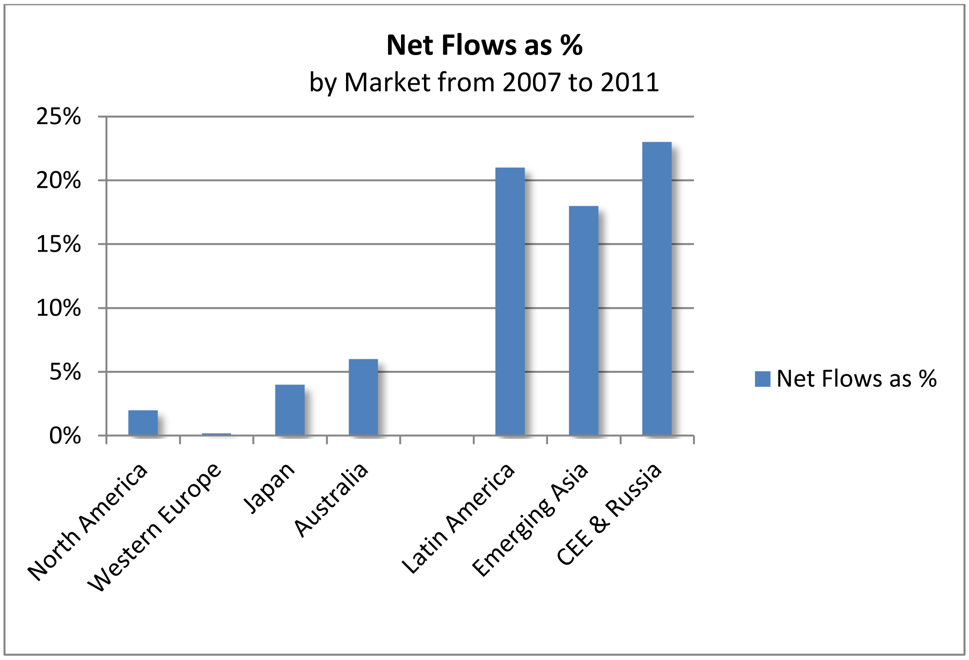

Figure 3-11: Net flows as percent for geographic regions. (McKinsey & Company, 2012) (McKinsey & Company, 2012)

Figure 3-11 shows the relationship of Net Flows to the assets available for managers from 2007 to 2011 when broken up by markets. The Developed Markets are showing little to no growth, while the Emerging Markets are showing significant growth. Combined with the overall industry trend, it is clear that there is little overall growth in the assets available to investment managers and the growth which is occurring is concentrated in Emerging Markets. This trend is tied to the shifting of demographics towards a higher percentage of retirees in the overall Developed Markets population.

3.8 Summary and Implications of the External Environment

3.8.1 Strengths, Weaknesses, Opportunities, Threats

The Strengths, Weaknesses, Opportunities and Threats (SWOT) (Crossan, Rouse, Fry, & Killing, 2013) can be seen in Table 3-4. The individual items are arranged according to their relative importance with the most important items at the top.

Strengths	Weaknesses
• Long performance track record and history • Good recent and long term performance of low risk product • Customized service • Ability to perform specialized investment research and to create highly customized investment product. • Have excess capacity to manage more assets with no additional overhead costs.	• Weak recent performance of key products • Pre-retirement aged Portfolio Managers in a relationship driven business. • Limited investment product types. • Limited financial services. • Brand is not recognizable outside of the local industry insiders.
Opportunities	**Threats**
• Very small independent investment managers are under cost pressures from government regulatory requirements. • Increase in retirement age investors interested in low risk product • Many independent investment firms are owned and operated by the Boomer generation and so are ready to sell their businesses. • Traditional fixed income products are generating very low yields due to low interest rates. • Emerging Markets are showing growth of assets. • It is difficult to start an investment management firm.	• Increase in accessibility to a wide variety of investment products through the internet and low-price brokers. • Increase in costly government regulatory requirements. • Increased competitive pressure from banks and other large financial institutions offering easy to use, bundled, low price packages. • Developed Markets including Canada are showing very limited growth of assets.

Table 3-4: SWOT analysis. Source: Author.

There are three dominant themes which need to be addressed. One of Dovos' core products has underperformed in the past couple of years which has opened it to losing more clients.

The Canadian investment market growth has stagnated in the past 3 years and is projected to remain stagnant. This has increased competitive pressure from other investment managers, including big organizations which have far greater resources. The negative effect is compounded by the increased regulatory requirements which have increased costs.

The current Dovos sales force is nearing retirement which means that relationship motivated clients may leave. Additionally, even though the investment team, the client service team and the administration team have spare capacity, a significant portion of the sales force is no longer highly motivated to aggressively grow their client base and more of their time is spent servicing existing clients rather than acquiring new ones.

3.8.2 Summary

This section illustrated the competitive environment in which Dovos operates and it has shown the major demographic, regulatory and technological trends which are shaping it. The current Dovos strategy is not optimized to compete in the new environment and its current sources of advantage will erode over time.

The following section will propose three strategic alternatives designed to take advantage of Dovos’ strengths, focus its resources and configure it for success.

4 Strategic Alternatives

This section outlines three strategic alternatives designed to take advantage of the company's strengths and the competitive environment as outlined in the previous chapters. Each alternative is examined in four sections. The first section outlines the product that each option will focus on, including new products or changes to existing products. The second section shows how the option will distribute its product and acquire new assets to manage. The third section explains what changes to the firm's operations have to be made to implement the option. The fourth and final section shows what new revenue and EBIDTA the option will generate over a 5 year period. Combined, the content in these sections will be used to evaluate and compare the options.

The details of the financial models and some key assumptions made when constructing them are shown in Appendix A.

4.1 Strategic Option 1: Focus on Retirement Based Product

Given that population demographics are pushing more money towards retirement products, focusing on these products will help to attract individual investors and many institutional investors who service retirement aged population.

4.1.1 Product

The product will leverage research already conducted on Low Volatility-High Yield portfolios and will be focused around risk reduction and yield maximization. It will operate on two levels: stock selection and asset allocation. The first level, stock selection, will be customized for larger clients to provide a stock mix which hits each client's specific needs for yield as determined by their forecasted liabilities, deposits and redemptions. The second level, asset allocation, will look at the entire portfolio and mix the investment types such as equities, bonds, mortgages and markets such as Canada, U.S., Europe, South America and Asia. The asset allocation portion requires further research and investment of time and resources before it can be offered to clients. Providing that the research is successful and does create viable strategies, the value proposition is to offer market-like returns without market-like losses. Additionally, these portfolios can generate yields which are no longer generated by traditional fixed income products.

The strategic trade-off for Dovos is to essentially abandon or de-prioritize the classic Alpha based core equity product which has always been a Dovos core offering. This will possibly cause Dovos to lose some existing institutional clients.

4.1.2 Product Distribution and Acquisition of New Assets

This strategy works very well with existing asset gathering methodologies and the key to success will lie in maximizing Dovos' efforts on all these fronts. No new distribution methodologies are required. The key difference will be in the marketing used to attract clients through all current distribution channels.

- Direct Portfolio Manager sales
- Partner Program
- Retirement focused Separately Managed Assets (SMA)
- Offering Memorandum (OM) individual funds distribution

4.1.3 Operations and Efficiency

There are two operational changes required to implement this strategic option. The first is the hiring of additional motivated Portfolio Managers. Given that Portfolio Managers are compensated based on the total assets they manage, PMs with fewer assets are typically more motivated to aggressively grow their assets than ones with large books. Dovos' current Portfolio Managers are busy maintaining the existing assets and not all are motivated to aggressively seek new clients.

The second change is the outsourcing of other Dovos products, including the core Alpha strategy. The retirement product requires a significant ongoing investment of research time, which is a strategic resource. In order to keep the product best in its class, Dovos must focus its research on continuously improving the product.

The trade off for this tactic is that institutional clients who hired Dovos for the Core Alpha strategy will leave. This represents around 16% of current AUM and 5% of current revenue. In essence, this will shift Dovos revenue completely away from these types of institutional clients to private clients and institutional clients who are seeking retirement like products.

4.1.4 Financial Summary

Table 4-1 summarizes the financial outlook of implementing Option 1.

Option 1 Key Financial Summary (CAD)						
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	6,100,000	6,668,856	7,471,972	8,369,897	9,627,501	10,525,426
Costs	5,100,000	5,476,457	5,993,541	6,590,519	7,547,400	8,144,378
EBITDA	1,000,000	1,192,399	1,478,430	1,779,378	2,080,100	2,381,048
EBITDA YoY Growth		19.2%	24.0%	20.4%	16.9%	14.5%
EBITDA Cumulative Growth		19.2%	47.8%	77.9%	108.0%	138.1%

3 Year Revenue Growth	37.2%
5 Year Revenue Growth	72.5%
3 Year EBITDA growth	77.9%
5 Year EBITDA growth	138.1%

Table 4-1: Option 1 financial summary. Source: Author.

4.2 Strategic Option 2: Distribute to Emerging Markets

Given that the world economy and global demographics have pushed growth to the Emerging Markets, Dovos can focus on distributing its classic products to China, South America or Central and Eastern Europe.

4.2.1 Product

The assets available for investment managers in Emerging Markets are still growing in the traditional categories, such as classic Alpha equity based products and classic balanced mandates. Dovos has over 20 years of experience building these products and has a lineup which is ready to be distributed. While there is no need to specifically focus on retirement products which can be pursued on a spare capacity basis, the main effort can be concentrated on classic Dovos products. This allows Dovos to remain focused on the product it has always been building. The main driver for considering this option is the significant projected growth of the market. Dovos' balanced portfolio, which is aimed at the classic savings market, has outperformed the Median Manager Benchmark in 2012. This, combined with its 20 year history and the amount of growth projected for the market, should allow Dovos to capture new retail clients, while it continues to work on improving the product.

4.2.2 Product Distribution and Acquisition of New Assets

Given that Dovos has no contacts or experience selling in any Emerging Market; it would have to form a partnership with local Portfolio Managers. This would have to be more than the Partner Program, which is just a referral service, since Dovos has no facilities to service local clients. The best approach would be a Joint Venture with a local firm where Dovos would handle the product creation and back-office operations and the local firm would handle customer service and sales. The JV partner must have an effective sales force and be able to quickly grow and retain clients. Once a JV is in place, the Partner Program would be implemented locally to increase referrals and accelerate asset growth.

The main challenge behind this tactic is that Dovos has no control over the availability of a suitable JV partner. The search for such partner will take time and is not guaranteed to succeed. This option is therefore quite unpredictable. Additionally, in order for this option to be attractive against the other options, Dovos would need to retain 60% of the revenue and leave 40% to the JV partner. If the split is reduced to 50-50, then according to the model shown in Appendix A, the option is less attractive than the other options. Considering the high degree of uncertainty, this would make the option not worth considering. The 60-40 split may make finding a JV partner more difficult.

This strategy should be rolled out one territory at a time so that the company does not become overstretched.

4.2.3 Operations and Efficiency

The first major operational change is an increase in the regulatory burden on the company. The BCSC has strict requirements around the monitoring of foreign investments for signs of money laundering or ties to terrorism. Since Dovos would make investing foreign money a part of its core business, it would need to invest in additional infrastructure to monitor the financial activities of its emerging markets clients.

Additionally, the developing countries Dovos would be entering have their own regulatory bodies which would need to be satisfied. This would require Dovos to enlist local legal services and work through the appropriate filings. Depending on the specifics, this may be handled by the local JV partner.

Keeping costs low is essential to competing in these markets. Dovos should outsource as much of the back-office operations as possible. This will help to lower costs and if the right outsourcer can be found, it may provide additional experience with operating in the new market.

The trade-off of this tactic is that the outsourcing of the back-office may negatively impact the service for existing domestic clients who are used to a high level of customization and personal attention.

4.2.4 Financial Summary

Table 4-2 summarizes the financial outlook of implementing Option 2.

Option 2 Key Financial Summary (CAD)						
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	6,100,000	6,109,000	6,439,000	7,099,000	8,809,000	9,889,000
Costs	5,100,000	5,103,350	5,272,850	5,611,850	6,528,350	7,070,350
EBITDA	1,000,000	1,005,650	1,166,150	1,487,150	2,280,650	2,818,650
EBITDA YoY Growth		0.6%	16.0%	27.5%	53.4%	23.6%
EBITDA Cumulative Growth		0.6%	16.6%	48.7%	128.1%	181.9%

3 Year Revenue growth	16.4%
5 Year Revenue growth	62.1%
3 Year EBITDA growth	48.7%
5 Year EBITDA growth	181.9%

Table 4-2: Option 2 financial summary. Source: Author.

4.3 Strategic Option 3: Become a Service Provider to Portfolio Managers

Given that winning new assets from other investment managers is difficult and new assets are not being added to the market, this option sees Dovos grow its revenue by partnering up with highly successful Portfolio Managers who wish to become independent from their existing companies in order to realize higher returns on the assets they manage. Due to regulatory requirements, it is impossible to become an independent Portfolio Manager overnight without an investment in the appropriate registrations, compliance capabilities and other back-office items.

4.3.1 Product

Dovos will offer its extended back-office services to Portfolio Managers as a service which will allow the Portfolio Managers to focus on servicing their clients and making the investment decisions. Dovos currently has a fairly robust reporting capability, compliance service, corporate services such as human resources and office facilities. All of these must exist for Dovos to be able to operate as an investment manager in British Columbia. This allows Dovos to leverage its existing infrastructure. In return, the joining Portfolio Manager will split his or her revenue with Dovos according to a pre-determined schedule. The complete listing of services which will be offered is:

- Registration status as an Investment Manager in all major Canadian provinces.
- Annual regulatory filings to BCSC and CRA
- Office facilities including a receptionist.

- High quality quarterly client statements.
- Access to Dovos client seminars.
- Access to Dovos research and investment product.
- Corporate services including human resources, payroll, benefits.
- A highly competitive custody and trade execution rate due to bulk discounts available to firms of Dovos' size.

The trade-off of this option is that the Dovos brand would get diluted. In order for a Portfolio Manager to become registered under Dovos, he or she would have to operate under the Dovos brand, with a possibility of using their own name as a sub-brand. As a result, Dovos would still offer its own products in addition to being a brand behind these new Portfolio Managers. If one of them had any difficulties with his or her clients, Dovos would have limited capability to deal with the problem but it would bear the full responsibility. A similar issue can occur with compliance. Dovos can monitor compliance; however, it would have limited ability to enforce compliance. As such, if one of these PMs decided to break regulatory requirements, then Dovos would be liable to the BCSC.

The other major trade-off is that there would be competition for clients between Dovos' own Portfolio Managers and these new Portfolio Managers. This may create some challenging dynamics.

4.3.2 Product Distribution and Acquisition of New Assets

The model works through offloading asset acquisition to the serviced Portfolio Managers. It is their job to acquire and maintain their clients. The way Dovos acquires new assets is by finding these Portfolio Managers through two strategies. A headhunter will be hired to source and find suitable candidates and Dovos sales staff will spend a portion of their time sourcing leads for Portfolio Managers who are suitable candidates and may be interested in joining the company. In order for this model to work, a suitable Portfolio Manager must meet the following criteria.

- Manage assets of at least $100,000,000.
- Not be bound by strict non-solicit or non-compete clauses which would prevent him or her from bringing clients to Dovos.

In order to attract the Portfolio Manager, Dovos will have to pay him or her revenue multiple to "buy the book." The industry standard is to pay 1.0 to 1.5x annual revenue. Given that the PIM model gives the Portfolio Managers a higher share of the revenue, Dovos may be able to purchase the books with 0.75x annual revenue.

The trade-off is that this is a significant capital investment for Dovos and it will tie up considerable capital resources. Additionally, any Dovos sales time directed at finding these Portfolio Managers is not directed at finding new clients.

4.3.3 Operations and Efficiency

Support costs for new assets tied to the new Portfolio Managers increase more quickly than with Option 1. Each new Portfolio Manager will bring a new set of requirements and this can drive the costs up. As such, this option requires Dovos to become as cost effective as possible in order to protect the profits which can be eroded by an unforeseen increase in operational complexity. Additionally, the existing Dovos Portfolio Managers would have to be treated as customers of this Dovos service in order to treat everyone fairly.

Some labor intensive, commodity like back-office functions such as trade settlements or reconciliation should be outsourced as much as possible to drive down the costs. Dovos would still provide the regulation mandated compliance, registration and the overall packaged corporate service.

The major trade-off is that this option radically changes the Dovos identity from being a dedicated investment manager to being both, a service provider and an investment manager. This necessary internal culture shift may have hard to foresee impact on staff morale.

The second trade-off is that while currently Dovos can set its own requirements on the back-office department and thus fully control costs, when it becomes a service provider, Dovos will have to meet the expectations of the new serviced Portfolio Managers. The impact of this change is also difficult to predict given that Dovos has no experience in servicing the needs of non-Dovos Portfolio Managers.

The current Dovos back office technology and systems infrastructure will be able to handle up to 5 new Portfolio Managers before requiring a major upgrade. Once the upgrade point is reached, Dovos will be forced to upgrade its core accounting system, Client Relationship Management (CRM) system and surrounding technology infrastructure. Based on current estimates, this will cost between $500,000 and $750,000.

4.3.4 Financial Summary

Table 4-3 summarizes the financial outlook of implementing Option 3.

Option 3 Key Financial Summary (CAD)						
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	6,100,000	6,426,250	7,078,750	7,731,250	8,710,000	9,362,500
Costs	5,100,000	5,255,000	5,565,000	5,875,000	6,340,000	6,650,000
EBITDA	1,000,000	1,171,250	1,513,750	1,856,250	2,370,000	2,712,500
EBITDA YoY Growth		17.1%	29.2%	22.6%	27.7%	14.5%
EBITDA Cumulative Growth		17.1%	51.4%	85.6%	137.0%	171.3%

3 Year Revenue growth	26.7%
5 Year Revenue growth	53.5%
3 Year EBITDA growth	85.6%
5 Year EBITDA growth	171.3%

Table 4-3: Option 3 financial summary. Source: Author.

4.4 Options Evaluation and Recommendation

4.4.1 Evaluation Criteria

The three options can be scored and evaluated based on preferences according to the scoring criteria below.

4.4.1.1 Potential for Revenue Growth

This criterion captures the ability of an option to generate new revenue which would have been unavailable had the option not been implemented. It is scored on the projected revenue generated by an optimistic outcome for the option as described above. Revenue is net of any revenue sharing arrangements and so it evaluates only the revenue which is available to Dovos. The revenue growth is evaluated after a 5 year period. At the current budgeted revenue growth of 3%

annually, a 5 year growth of 16% is the base case. This criterion is weighted at 20% of the total score as growing the revenue is a key stated goal for the company.

Score	Meaning
1	Option has the potential to generate revenue growth lower than 16% after 5 years. Option is worse than keeping current growth plan even if it is successful.
2	Option has the potential to generate revenue growth between 16% and 32% after 5 years.
3	Option has the potential to generate revenue growth between 32% and 55% after 5 years.
4	Option has the potential to generate revenue growth between 55% and 70% after 5 years.
5	Option has the potential to generate revenue growth over 70% after 5 years.

4.4.1.2 Potential for Profit Growth

This criterion captures the additional new EBITDA that an option will be able to generate. While the EBITDA is linked to revenue, ultimately the shareholders are interested in how much profit an option will generate more than in how much raw revenue the option will generate. This is based on an ongoing pro-rata EBITDA which excludes one time startup costs. This criterion is weighted at 30% of the total as generating profit is the key requirement from the board.

Score	Meaning
1	Option has the potential to grow EBITDA by less than 50% after 5 years.
2	Option has the potential to grow EBITDA by between 50% and 100% after 5 years.
3	Option has the potential to grow EBITDA by between 100% and 150% after 5 years.
4	Option has the potential to grow EBITDA by between 150% and 200% after 5 years.
5	Option has the potential to grow EBITDA by over 200% after 5 years.

4.4.1.3 Time to Profit

This criterion evaluates the time needed to see first signs of significant EBITDA growth. The criterion looks at the number of years needed by the option to increase EBITDA by 50%. This criterion is weighted at 10% of the total as getting to the revenue quickly is not as important as the other criteria.

Score	Meaning
1	Option will generate EBITDA growth of 50% after more than 4 years or never.
2	Option will generate EBITDA growth of 50% after at most 4 years.
3	Option will generate EBITDA growth of 50% after at most 3 years.
4	Option will generate EBITDA growth of 50% after at most 2 years.
5	Option will generate EBITDA growth of 50% after at most 1 year.

4.4.1.4 Risk

This criterion captures the overall inherent risk in implementing the option. This is a qualitative assessment of whether the option requires highly optimistic events to occur for it to capture its stated revenue potential. Risk also captures the likelihood of the option failing to generate any new revenue and of costing the company its investment. This criterion is weighted at 25% of the total as risk is an important consideration. Even if an option has great revenue and profit potential, it is undesirable if it places the company at risk of losing its investment or if it requires very optimistic results.

Score	Meaning
1	Option requires very unlikely events or the option has a high possibility of failure.
2	Option requires unlikely events or the option has a significant possibility of failure.
3	Option requires somewhat likely events or the option has a somewhat low possibility of failure.
4	Option requires likely events or the option has a low of failure.
5	Option requires very likely events or the option has a very low possibility of failure.

4.4.1.5 Capital Investment Required

This criterion captures the amount of capital the company must invest in executing the option in order to have a chance of achieving the Revenue Potential. It reflects the resource drain on the company as well as the likelihood that the company will be able to raise sufficient capital to execute the option. This criterion is weighted at 15% of the total as it is important for the company to not over-invest itself in a single option at the cost of its core business.

Score	Meaning
1	Option requires a capital investment of more than 1x annual revenue.
2	Option requires a capital investment between .5x and 1x annual revenue.
3	Option requires a capital investment between 0.5x and 0.25x annual revenue.
4	Option requires a capital investment between 0.25x and 0.1x annual revenue.
5	Option requires a capital investment lower than 0.1x annual revenue.

4.4.2 Combined Option Evaluation and Summary

The individual rankings of the options can be seen below. For a detailed analysis of the numbers behind the options, please see Appendix A.

Evaluation Criteria	Weight	Option 1: Retirement Product Focus	Option 2: Emerging Markets	Option 3: PM Service Provider
Potential for Revenue Growth	20%	5	4	3
Potential for Profit Growth	30%	3	4	4
Time to Profit	10%	4	3	4
Risk	25%	4	1	3
Capital Investment Required	15%	4	2	1
Total	**100%**	**3.9**	**2.9**	**3.1**

Table 4-4: Strategic option preference analysis. Source: Author.

Table 4-4 shows the individual scores for each option against each criterion as well as the combined score. Option 1 is the preferred option before considering feasibility. Option 2 and Option 3 show the same EBITDA growth when mapped onto the 1-5 evaluation scale, however, Option 2 has the highest EBITDA potential when examined in detail. Option 2 also comes with the greatest risk. Option 3 provides a second best EBITDA; however, it has the highest capital investment required. The feasibility of each option will be examined in the following section which will then allow for the final recommendation to be made.

5 Feasibility Analysis of the Strategic Options

The feasibility of each of the strategic options is analyzed below using a framework based on the "Diamond-E Framework" (Crossan, Rouse, Fry, & Killing, 2013).

5.1 Strategic Option 1: Focus on Retirement Based Product

Strategic Option 1 involves a number of separate initiatives designed to work together, however, the Strategic Option may be a good alternative even if only some of the initiatives are feasible.

5.1.1 Managerial Requirements and Gaps

5.1.1.1 Preferences and Decision Criteria

Requirement	Managers are willing to de-prioritize the Dovos Classic Alpha and Balanced product in favor of a Retirement Focused product
Gap	No major gap.
Gap Filling Solution	None necessary
Cost	None

5.1.1.2 Experience

Requirement	Offering Memorandum distribution requires Management to be proficient in operating a pooled fund distributed to many independent Portfolio Managers nationally.
Gap	Currently management does not have this proficiency.
Gap Filling Solution	Training and hiring of consultants such as legal and accounting advisors
Cost	Low

5.1.1.3 Team Composition

Requirement	Management team must be diversified and well versed in the running of an investment management firm
Gap	No gap exists
Gap Filling Solution	None needed
Cost	None

5.1.1.4 Summary

Overall the managerial gaps are small or have low gap filling costs.

5.1.2 Organizational Requirements and Gaps

5.1.2.1 Structure

Requirement	Investment research team is capable of constructing customized Low Volatility High Yield strategies including Asset Allocation.
Gap	Dovos does have an investment research team; however, much of their time is dedicated to legacy Alpha product.
Gap Filling Solution	Hire a junior team member to support legacy product or outsource the legacy product so that the existing top team members can be dedicated to researching the retirement based strategies.
Cost	Low to Medium.

5.1.2.2 Systems

Requirement	Investment research technology and access to data necessary for the construction of custom Low Volatility and High Yield retirement focused products
Gap	Dovos currently has such technology and data.
Gap Filling Solution	None needed
Cost	None.

Requirement	Efficient SMA portfolio management system capable of potentially handling hundreds of different SMA accounts
Gap	Dovos currently has a very simple system for managing SMA accounts which treats them as special cases of the normal Dovos accounts. The current system is sufficient for less than 10 accounts at which point a more robust solution will be necessary.
Gap Filling Solution	The current system will need to be extended. There is no need for a replacement of the underlying system.
Cost	Medium.

5.1.2.3 Culture

There are no significant Culture requirements needed for this option.

5.1.2.4 Summary

Overall the structural requirements for this option are low to medium.

5.1.3 Resource Requirements and Gaps

5.1.3.1 Operational

Requirement	If many new SMA portfolios are launched, Dovos will require staff dedicated to managing the SMA book of business. Each account will have its own particular requirements which will need to be monitored to ensure that nothing is missed.
Gap	Such staff does not currently exist. SMA accounts are managed as a split responsibility amongst existing staff.
Gap Filling Solution	Hire and train additional staff as required.
Cost	Low to Medium. This cost should be fully marginal and incurred only if there is sufficient revenue to require it.

5.1.3.2 Human

Requirement	Dovos must have Portfolio Managers who are motivated to work with referral partners to generate and capture referral leads.
Gap	Current Dovos Portfolio Managers are quite busy with their existing clients and not motivated to take on referrals which generate less revenue for them than their own clients.
Gap Filling Solution	Hire a new Portfolio Manager with a small client list or promote someone internally to the role of a Portfolio Manager who will be highly motivated.
Cost	Medium.

5.1.3.3 Financial

There are no significant financial gaps required for this option.

5.1.3.4 Summary

Overall the costs of the resource gaps are medium.

5.2 Strategic Option 2: Distribute to Emerging Markets

5.2.1 Managerial Requirements and Gaps

5.2.1.1 Preferences and Decision Criteria

Requirement	Firm founders have to be open to operating the company in Emerging Markets which is a very different direction from what Dovos has done historically.
Gap	This option has not been considered before so their openness to making this move is unknown.
Gap Filling Solution	The founders and the management team have to be educated on the reality of doing business in a chosen Emerging Market. This will involve trips and consultation with appropriate experts. At the end of the exercise, this gap may still not be filled.
Cost	Medium

5.2.1.2 Experience

Requirement	Management must have experience in dealing with the regulatory and business particulars of the specific chosen Emerging Market
Gap	Currently the management team has no such experience.
Gap Filling Solution	The team would have to be augmented by either hiring a full time manger with the necessary experience or by engaging a consulting firm.
Cost	Medium to High

5.2.1.3 Team Composition

Requirement	Management team must have a local representative who can work with local regulatory bodies.
Gap	Currently the management team lacks this representation.
Gap Filling Solution	The team would have to be augmented by hiring a local representative.
Cost	Medium

5.2.1.4 Summary

Overall the management costs for this option are medium to high.

5.2.2 Organizational Requirements and Gaps

5.2.2.1 Structure

Requirement	With the local operations mostly handled by a Joint Venture partner, Dovos will require a small liaison department which will coordinate operations between the Canadian back office and the local distributor
Gap	Dovos does not have this department
Gap Filling Solution	The new department must be created
Cost	Medium to High

5.2.2.2 Systems

Requirement	Dovos will require a robust compliance system which will satisfy BCSC that our Emerging Market clients are not a high risk for money laundering or terrorism.
Gap	Dovos has a compliance system but it was designed for Canadian and US clients.
Gap Filling Solution	The Dovos system has to be extended or replaced with a 3rd party solution.
Cost	Medium

Requirement	Dovos will require a client database and client trade system which can work in a satellite office and connect to the Canadian headquarters.
Gap	Current Dovos system was designed to be used in a single location but it does have the capability to be used remotely. It currently requires a fast internet connection which may be problematic.
Gap Filling Solution	The current system can be enhanced to fully support true remote work. Alternatively a robust 3rd party system can be licensed which will replace the Dovos system.
Cost	Medium to extend and test current system. High to replace current system with a 3rd party system.

5.2.2.3 Culture

Requirement	Dovos staff will have to be proficient in dealing with the Joint Venture partner requests and business culture.
Gap	Currently Dovos staff is only familiar with the Canadian business culture.
Gap Filling Solution	Dovos staff will have to be trained.
Cost	Low to Medium.

5.2.2.4 Summary

Overall the organizational requirements are medium to high.

5.2.3 Resource Requirements and Gaps

5.2.3.1 Operational

Requirement	Dovos must have the ability to operate an Investment Management business in a specific Emerging Market country
Gap	Currently Dovos does not have the necessary registrations or capability.
Gap Filling Solution	Dovos will form a Joint Venture with a local partner interested in distributing the Dovos product or find a suitable buy out target.
Cost	High and very uncertain. It is difficult to estimate the likelihood that Dovos will find an appropriate Joint Venture partner or buy out target.

Requirement	Dovos will have to be able to process transactions from Emerging Market banks.
Gap	Currently Dovos deals with Developed Market banks only.
Gap Filling Solution	If the current Dovos custodian is not able to effectively deal with local Emerging Market banks, then an alternative custodian with a global reach will be employed. For example Citi Bank.
Cost	Medium to High if Dovos has to switch custodian to Citi Bank.

5.2.3.2 Human

Requirement	Dovos will have to have access to local staff that will run the Investment Management office, act as the Portfolio Manager and Client Service representative.
Gap	Dovos does not have such staff.
Gap Filling Solution	Dovos will form a Joint Venture with a local partner interested in distributing the Dovos product or find a suitable buy out target.
Cost	High and very uncertain. It is difficult to estimate the likelihood that Dovos will find an appropriate Joint Venture partner or buy out target.

5.2.3.3 Financial

Requirement	Dovos must have sufficient funding to acquire a small local Investment Management firm or to form a Joint Venture. Additional funding must be available to sponsor the local operations until the new venture grows to be self sufficient.
Gap	Dovos has access to pre-approved credit; however, the amount will likely not be sufficient.
Gap Filling Solution	Additional funding must be secured so that Dovos can improve its capabilities and sponsor the partner
Cost	Medium and uncertain. It is not clear whether Dovos will be able to secure sufficient funding for this venture.

5.2.3.4 Summary

Overall the resource requirements are medium to high and carry significant uncertainty.

5.3 Strategic Option 3: Become a Service Provider to PMs

5.3.1 Managerial Requirements and Gaps

5.3.1.1 Preferences and Decision Criteria

Requirement	The founders and the management have to be willing to explore options which shift the company from being a pure investment manager to also being a service provider.
Gap	Current Dovos management and founders are interested in pursuing alternatives which redefine the business model.
Gap Filling Solution	None required.
Cost	None.

5.3.1.2 Experience

Requirement	The management must have experience running a back-office with a client service and a compliance sections.
Gap	None. Currently Dovos runs such a back-office.
Gap Filling Solution	None needed.
Cost	None.

Requirement	The management should have experience running a service organization.
Gap	The current Dovos set-up has a service mindset towards the clients whose money is invested. This mindset would have to be shifted towards treating the Portfolio Managers as clients.
Gap Filling Solution	Shift in managerial mindset towards Portfolio Managers.
Cost	None.

Requirement	Once there are multiple Portfolio Managers occupying multiple satellite offices, the management must be experienced in running a multi-site operation.
Gap	Currently the management has no experience with a multi-site office.
Gap Filling Solution	Additional training or consulting as needed.
Cost	Low.

5.3.1.3 Team Composition

Requirement	The management must have managers familiar with BCSC's regulatory requirements and with how Portfolio Managers like to operate.
Gap	The current Dovos management does possess this knowledge through its team members.
Gap Filling Solution	None needed.
Cost	None.

5.3.1.4 Summary

Overall the management requirements are low.

5.3.2 Organizational Requirements and Gaps

5.3.2.1 Structure

Requirement	Dovos has to be organized so that the Portfolio Managers have their needs met and are satisfied as clients.
Gap	The current set-up has Portfolio Managers as employees of the Sales Department working with the Client Service section, the Administration Department and the Investment Department. While these departments do service the current Portfolio Managers, it is not a true client-service provider relationship.
Gap Filling Solution	The servicing departments would have to be reorganized so that they were motivated to treat the new Portfolio Managers as clients. This setup would then apply to all Portfolio Managers so that everyone received a fair service.
Cost	Low to Medium. This is primarily a training and compensation structure issue. Each additional PM adds to the cost as additional staff will be required.

5.3.2.2 Systems

Requirement	Dovos would have to implement a system which would ensure a fair treatment of all Portfolio Managers and a fair treatment of all end clients.
Gap	Dovos has no experience with working for Portfolio Managers coming from different organizations with different habits and requirements. It is possible that while the program is getting started, errors will be made or specific needs of the new Portfolio Managers will not be met.
Gap Filling Solution	Dovos must implement an iterative system of improvements and feedback in conjunction with oversight from Compliance to ensure that all Portfolio Managers and their clients are treated fairly.
Cost	Low. This is primarily a training and procedural issue.

Requirement	Dovos must have a flexible trading platform which can be used by Portfolio Managers to choose their own stocks for their clients.
Gap	The current system allows Portfolio Managers to choose the Dovos Pooled Funds only. All individual stock picking is done by the investment department.
Gap Filling Solution	The current system has to be extended or a new 3rd party system must be implemented which will allow the Portfolio Managers to choose stocks and directly control their client's investments
Cost	Medium to High. If the current system can be extended then the costs are lower. The current system is not robust enough to handle more than 5 Portfolio Managers. A 3rd party system can be relatively expensive to license. This will be necessary once 6 or more Portfolio Managers are signed up.

5.3.2.3 Culture

Requirement	Dovos has to be open to the idea that its Investment Team is not the only product creator at the company and that the Dovos investment brand will be diluted.
Gap	The current culture is focused on Dovos Investments being the only identity of Dovos.
Gap Filling Solution	This requires a shift in thinking of the staff, especially the Investment Team.
Cost	None.

5.3.2.4 Summary

Overall the organizational requirements are low to medium.

5.3.3 Resource Requirements and Gaps

5.3.3.1 Operational

Requirement	Dovos must have adequate space to provide seating for the new Portfolio Managers and their associates.
Gap	The current Dovos office space is only large enough to house one more Portfolio Manager. Additional Portfolio Managers will require more space.
Gap Filling Solution	A satellite office will be leased in the proximity of the main Dovos office. The office would be able to handle two to five Portfolio Managers. If additional space is needed, additional offices can be leased.
Cost	None to Medium to High as the requirement moves from not needing any additional office space to needing multiple additional offices.

Requirement	Dovos requires an IT infrastructure which can handle multiple satellite offices.
Gap	Current Dovos infrastructure is designed for a single office with a single off-site backup.
Gap Filling Solution	The infrastructure would need to be extended.
Cost	Medium. The current infrastructure is extensible and should scale with the addition of hardware and contract labor for the initial setup.

Requirement	Dovos requires a bulk client on-boarding system so that a joining Portfolio Manager can quickly open accounts for all of their clients.
Gap	Current Dovos client on-boarding system is heavily manual and is designed for single accounts being opened individually.
Gap Filling Solution	Dovos would need to develop automation to help with the account opening process.
Cost	Medium. The problem itself is well understood which makes this an implementation problem.

5.3.3.2 Human

Requirement	Dovos must have sufficient staff to handle the additional workload new Portfolio Managers with many clients would create.
Gap	Currently Dovos staff is optimized for the Dovos clients and slow, organic growth.
Gap Filling Solution	New staff will have to be hired.
Cost	Medium to High. Depending on the number of new Portfolio Managers and clients that are being brought on-board.

5.3.3.3 Financial

Requirement	Dovos requires sufficient funds to purchase the service contract from the new Portfolio Manager. Typically, a substantial incentive based a multiple of total revenue from all clients is paid to the Portfolio Manager for the business. Funds are also needed to make any of the system improvements and to hire new staff as required by the number of new Portfolio Managers.
Gap	Dovos has access to a pre-approved credit line which can be used to fund a single new Portfolio Manager.
Gap Filling Solution	Additional funds will need to be secured to fund additional Portfolio Managers.
Cost	Medium. The availability of the additional funding is not guaranteed. This Gap increases in cost with each additional PMs

5.3.3.4 Summary

Overall the resource requirements are Medium with the exception of funding if multiple Portfolio Managers are to be brought on board.

5.4 Feasibility Summary

Table 5-1 illustrates the individual option feasibility for each requirement type and the final average feasibility. Score of 5 indicates the smallest gap, or an easy to fill gap.

Feasibility Requirement Category	Option 1: Retirement Product Focus	Option 2: Emerging Markets	Option 3: PM Service Provider
Management			
Preferences and Decision Criteria	5.0	3.0	5.0
Experience	5.0	2.0	5.0
Team Composition	5.0	3.0	5.0
Organization			
Structure	4.0	2.0	4.0
Systems	4.0	3.0	4.0
Culture	5.0	4.0	5.0
Resources			
Operational	4.0	1.0	3.0
Human	3.0	1.0	2.0
Financial	5.0	2.0	3.0
Average	4.4	2.3	4.0

Table 5-1: Strategic options feasibility summary. Source: Author.

Option 1 has the highest feasibility with Option 3 being a close second. Option 2 has low feasibility with significant Operational and Human resource gaps which may be very difficult to fill.

6 Final Recommendation

6.1 Options Choice

Option 1: Focus on Retirement Products is the recommended option. This multi-faceted option includes a number of initiatives which can be implemented as the opportunity arises. Given that the social demographics of investors in the Developed Markets such as Canada are shifting towards retirement age and given that there is increased fear of market instability, the demand for investments built around protecting wealth, generating income and avoiding risk will keep increasing for decades.

Option 2: Emerging Markets is very attractive from the potential revenue and profit generation side, however, the option is very risky for Dovos given the company's lack of experience in operating outside of Canada. This option would be worth pursuing if there were no safer alternatives or if Dovos had sufficient resources to pursue the strategy without risking negative impact on the core Canadian business.

Option 3: Service Other Portfolio Managers is a middle of the road option with the second highest predicted pay off and medium risk. This option has the advantage of generating revenue fairly quickly and the disadvantage of requiring a capital investment to bring the Portfolio Managers on board. On the other hand, this option is perpendicular to the core investment strategy so it is feasible for the company to pursue Option 1 and Option 3 at the same time.

6.2 Timeline

This action plan deals with *reactive* changes (Crossan, Rouse, Fry, & Killing, 2013) and as such, it can be implemented over a 12 month period with quarterly evaluation points. There are three major objectives:

- Develop a complete retirement based product lineup based around the Low Volatility High Yield research.
- Increase the internal sales force by at least one more junior Portfolio Manager.
- Add four more referral partners.

The high level timeline for the next 12 months should be implemented as listed in Table 6-1.

Activity	Completed by
Hire a Junior Investment Researcher to take on Core Alpha product and free up Research Team for new product development	1 month
Create enhanced retirement based product for the SMA channel	3 months
Hire a new Portfolio Manager to focus on growing assets through referral partners	3 months
Find at least one more referral partner for the Partner Program	3 months
Register the Dovos (OM) funds with Advisors	6 months
Find at least one more referral partner for the Partner Program	6 months
Complete research on the Asset Selector model	9 months
Find at least one more referral partner for the Partner Program	9 months
Enhance the Low Volatility High Yield product to ensure its competitiveness.	12 months

Table 6-1: Strategic option implementation timeline. Source: Author.

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Appendix A

Option 1 – Retirement Product

Key Assumptions	Revenue Multiple	Average Size in AUM	Average Revenue per Client
Current Revenue	$ 6,100,000		
Client acquisition rate will double current			
Year 4 will see a single big client (represented by many small ones)			
Private Clients	0.775%	$ 750,000	$ 5,810
Institutional Clients	0.300%	$ 20,000,000	$ 59,946
AveragePartner Program Referral Fee	50%		

Projections		Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
New Private Clients per year			24	48	48	48	48
New Private Referral Clients per year			24	36	48	48	48
New Institutional Clients per year			4	4	4	4	4
New Institutional Referral Clients per year			4	6	8	20	8
New AUM			$ 196,000,000	$ 263,000,000	$ 312,000,000	$ 552,000,000	$ 312,000,000
Total New AUM			$ 196,000,000	$ 459,000,000	$ 771,000,000	$ 1,323,000,000	$ 1,635,000,000
Total Firm AUM		$ 1,200,000,000	$ 1,396,000,000	$ 1,659,000,000	$ 1,971,000,000	$ 2,523,000,000	$ 2,835,000,000
Revenue							
New Revenue			$ 568,856	$ 803,116	$ 897,925	$ 1,257,604	$ 897,925
Total New Revenue			$ 568,856	$ 1,371,972	$ 2,269,897	$ 3,527,501	$ 4,425,426
Total Firm Revenue		$ 6,100,000	$ 6,668,856	$ 7,471,972	$ 8,369,897	$ 9,627,501	$ 10,525,426
Year over Year percent growth			9.3%	12.0%	12.0%	15.0%	9.3%
Costs							
New Manufacturing Costs	0.15%		$ 294,000	$ 394,500	$ 468,000	$ 828,000	$ 468,000
New PM Compensation	30%		$ 82,457	$ 122,585	$ 128,978	$ 128,881	$ 128,978
Combined New Costs			$ 376,457	$ 517,085	$ 596,978	$ 956,881	$ 596,978
Total New Variable Costs			$ 376,457	$ 893,541	$ 1,490,519	$ 2,447,400	$ 3,044,378
Total Firm Costs		$ 5,100,000	$ 5,476,457	$ 5,993,541	$ 6,590,519	$ 7,547,400	$ 8,144,378
New EBITDA			$ 192,399	$ 286,031	$ 300,948	$ 300,723	$ 300,948
Total New EBITDA			$ 192,399	$ 478,430	$ 779,378	$ 1,080,100	$ 1,381,048
Margin on New Revenue			33.8%	35.6%	33.5%	23.9%	33.5%
Total Firm EBITDA		$ 1,000,000	$ 1,192,399	$ 1,478,430	$ 1,779,378	$ 2,080,100	$ 2,381,048
Year on Year EBITDA growth			19.2%	24.0%	20.4%	16.9%	14.5%
3 Year EBITDA growth		77.9%					
5 Year EBITDA growth		138.1%					
3 Year Revenue growth		37.2%					
5 Year Revenue growth		72.5%					

Option 2 – Emerging Markets

Key Assumptions				
Current Revenue		$ 6,100,000		
Year 4 will see a big client represented by many small clients				
One Time Partner search costs -- Ignored				
One Time Legal setup costs -- Ignored				
One Time Infrastructure costs -- Ignored				
JV Revenue Own Firm Portion	60%			
Mangement Fees			based on Schroders Brazil	
Private	1.50%		http://www.schroders.com.br/	
Institutional	0.80%			
		Revenue Multiple	Average Size in AUM	Average Revenue per Client
Private Clients		0.90%	$ 200,000	$ 1,800
Institutional Clients		0.48%	$ 10,000,000	$ 48,000

Projections		Year 0	Year 1	Year 2	Year 3	A big Client Year 4	Year 5
New Private Clients per year			5	50	100	150	200
New Institutional Clients per year			0	5	10	30	15
New Private AUM per year			$ 1,000,000	$ 10,000,000	$ 20,000,000	$ 30,000,000	$ 40,000,000
New Institutional AUM per year			$ -	$ 50,000,000	$ 100,000,000	$ 300,000,000	$ 150,000,000
Combined New AUM			$ 1,000,000	$ 60,000,000	$ 120,000,000	$ 330,000,000	$ 190,000,000
Total New AUM			$ 1,000,000	$ 61,000,000	$ 181,000,000	$ 511,000,000	$ 701,000,000
Total Firm AUM		$ 1,200,000,000	$ 1,201,000,000	$ 1,261,000,000	$ 1,381,000,000	$ 1,711,000,000	$ 1,901,000,000
Revenue							
New Private Revenue per year			$ 9,000	$ 90,000	$ 180,000	$ 270,000	$ 360,000
New Institutional revenue per year			$ -	$ 240,000	$ 480,000	$ 1,440,000	$ 720,000
Combined New Revenue			$ 9,000	$ 330,000	$ 660,000	$ 1,710,000	$ 1,080,000
Total New Revenue			$ 9,000	$ 339,000	$ 999,000	$ 2,709,000	$ 3,789,000
Total Revenue		$ 6,100,000	$ 6,109,000	$ 6,439,000	$ 7,099,000	$ 8,809,000	$ 9,889,000
Year over Year percent growth			0.1%	5.4%	10.3%	24.1%	12.3%
Costs							
New Manufacturing Costs	0.20%		$ 2,000	$ 120,000	$ 240,000	$ 660,000	$ 380,000
New PM Compensation	15%		$ 1,350	$ 49,500	$ 99,000	$ 256,500	$ 162,000
Combined New Costs			$ 3,350	$ 169,500	$ 339,000	$ 916,500	$ 542,000
Total New Costs			$ 3,350	$ 172,850	$ 511,850	$ 1,428,350	$ 1,970,350
Total Firm Costs		$ 5,100,000	$ 5,103,350	$ 5,272,850	$ 5,611,850	$ 6,528,350	$ 7,070,350
New EBITDA			$ 5,650	$ 160,500	$ 321,000	$ 793,500	$ 538,000
Total New EBITDA			$ 5,650	$ 166,150	$ 487,150	$ 1,280,650	$ 1,818,650
Margin on New Revenue			62.8%	48.6%	48.6%	46.4%	49.8%
Total Firm EBITDA		$ 1,000,000	$ 1,005,650	$ 1,166,150	$ 1,487,150	$ 2,280,650	$ 2,818,650
Year on Year EBITDA growth			0.57%	15.96%	27.53%	53.36%	23.59%
3 Year EBITDA growth		48.7%					
5 Year EBITDA growth		181.9%					
3 Year Revenue growth		16.4%					
5 Year Revenue growth		62.1%					

Option 3 – Become a Service Provider to Portfolio Managers

Key Assumptions		
Current Revenue	$ 6,100,000	
Year 4 will see a big client represented by many small clients		
Average Partner AUM	$ 150,000,000	Assumes no major infrastructure changes are needed for 5 PMs.
Average Fee Rate	1.00%	
Average Revenue	$ 1,500,000	
Average Purchase Revenue Multiplier	75%	Required to entice PMs to join.
Average Purchase Price	$ 1,125,000	Firm "purchases" revenue stream. Industry standard.
Custodian and Trade Fees (0.13%)	$ 195,000	
Gross Revenue	$ 1,305,000	
Average PM Revenue Portion	75%	PM keeps majority of revenue and
PM Pay Out	$ 978,750	can hire additional support staff
Company Share of Revenue	$ 326,250	
Expenses Per PM		
Rent average	$ 30,000	(assumes 1 $60k / year office can be shared by two PMs)
Office expenses average	$ 30,000	
Software and Data Licenses	$ 45,000	
Additional Staff	$ 20,000	
Middle Office at (0.02%)	$ 30,000	
Total Marginal Costs per PM	$ 155,000	
EBITDA	$ 171,250	
Margin	13.1%	
Margin Net of PM Share	52.5%	

Projections		Year 1	Year 2	Year 3	Year 4	Year 5
New PMs		1	2	2	3	2
Total serviced PMs		1	3	5	8	10
New Purchase Price		$ 1,125,000	$ 2,250,000	$ 2,250,000	$ 3,375,000	$ 2,250,000
Total Purchase Price		$ 1,125,000	$ 3,375,000	$ 5,625,000	$ 9,000,000	$ 11,250,000
New AUM		$ 150,000,000	$ 300,000,000	$ 300,000,000	$ 450,000,000	$ 300,000,000
Total New AUM		$ 150,000,000	$ 450,000,000	$ 750,000,000	$ 1,200,000,000	$ 1,500,000,000
Total Firm AUM	$ 1,200,000,000	$ 1,350,000,000	$ 1,650,000,000	$ 1,950,000,000	$ 2,400,000,000	$ 2,700,000,000
Revenue						
New Revenue		$ 1,500,000	$ 3,000,000	$ 3,000,000	$ 4,500,000	$ 3,000,000
Total New Revenue		$ 1,500,000	$ 4,500,000	$ 7,500,000	$ 12,000,000	$ 15,000,000
Total Firm Revenue	$ 6,100,000	$ 7,600,000	$ 10,600,000	$ 13,600,000	$ 18,100,000	$ 21,100,000
Net Year over Year Growth		25%	39%	28%	33%	17%
New Gross Revenue		$ 326,250	$ 652,500	$ 652,500	$ 978,750	$ 652,500
Total New Gross Revenue		$ 326,250	$ 978,750	$ 1,631,250	$ 2,610,000	$ 3,262,500
Total Firm Gross Revenue	$ 6,100,000	$ 6,426,250	$ 7,078,750	$ 7,731,250	$ 8,710,000	$ 9,362,500
Costs						
New Costs		$ 155,000	$ 310,000	$ 310,000	$ 465,000	$ 310,000
Total New Costs		$ 155,000	$ 465,000	$ 775,000	$ 1,240,000	$ 1,550,000
Total Firm Costs	$ 5,100,000	$ 5,255,000	$ 5,565,000	$ 5,875,000	$ 6,340,000	$ 6,650,000
New EBITDA		$ 171,250	$ 342,500	$ 342,500	$ 513,750	$ 342,500
Total New EBITDA		$ 171,250	$ 513,750	$ 856,250	$ 1,370,000	$ 1,712,500
Total Firm EBITDA	$ 1,000,000	$ 1,171,250	$ 1,513,750	$ 1,856,250	$ 2,370,000	$ 2,712,500
Year on Year EBITDA growth		17%	29%	23%	28%	14%
Margin		52%	52%	52%	52%	52%
3 Year EBITDA growth	85.6%					
5 Year EBITDA growth	171.3%					
3 Year Revenue growth	26.7%					
5 Year Revenue growth	53.5%					